

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, 1998

Commission File Number 0-23006

DSP GROUP, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation and organization)

94-2683643
(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 1, 1999, as reported on the Nasdaq National Market, was approximately \$107,277,023. 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 1, 1999 the Registrant had outstanding 11,633,420 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, 1998 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 1998 Annual Report is not deemed filed as part of this Report.

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THIS ANNUAL REPORT ON FORM 10-K CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS THAT ARE BASED ON THE BELIEFS OF, AND ESTIMATES MADE BY AND INFORMATION CURRENTLY AVAILABLE TO, DSP GROUP'S MANAGEMENT. THESE STATEMENTS ARE SUBJECT TO RISKS AND UNCERTAINTIES. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE DISCUSSED HERE. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED BELOW IN "FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS" AND ELSEWHERE IN THIS ANNUAL REPORT ON FORM 10-K.

THE TERMS "DSP GROUP," "WE," "OUR" AND "US" AS USED IN THIS ANNUAL REPORT ON FORM 10-K REFER TO "DSP GROUP, INC." AND ITS SUBSIDIARIES AS A COMBINED ENTITY, EXCEPT WHERE IT IS MADE CLEAR THAT THE TERM ONLY MEANS THE PARENT COMPANY. IN ADDITION, THIS ANNUAL REPORT ON FORM 10-K INCLUDES TRADEMARKS AND REGISTERED TRADEMARKS OF DSP GROUP. PRODUCTS OR SERVICE NAMES OF OTHER COMPANIES MENTIONED IN THIS ANNUAL REPORT ON FORM 10-K MAY BE TRADEMARKS OR REGISTERED TRADEMARKS OF THEIR RESPECTIVE OWNERS.

PART I

ITEM 1. BUSINESS.

GENERAL BUSINESS

DSP Group develops and markets products and technologies that perform digital signal processing--the electronic manipulation of digitized speech and other digital signals. DSP Group's products are used in a wide variety of telephony and other communications devices to enhance the functionality of these devices.

Digital speech technology provides several advantages over analog speech technology, including higher levels of speech compression and greater ability to process and manipulate data. In addition, digital speech products that use programmable digital signal processors can be developed faster than analog speech products, which require dedicated analog hardware. As a result, digital speech technology is widely incorporated today in telephone answering devices ("TADs") and many other types of telephony and communications products. Digital speech technology also enables a new generation of products to transmit live speech over data networks and perform audio and video conferencing over standard telephone lines.

Our work in the field of digital speech and digital signal processing has yielded three synergistic product families:

- Speech and telephony processors--integrated circuit devices that

process digitized speech and other digital signals.

- DSP cores--proprietary architectures for central processing units

that, when combined with other circuits such as memory and input/output circuits, form a complete circuit design for speech and telephony processors.
- TrueSpeech-Registered Trademark---a family of proprietary speech

compression algorithms.

In addition, DSP Group entered the cordless telephony business in the first quarter of 1999 by acquiring two integrated groups of engineers who specialize in the design of integrated circuits for wireless communication and by acquiring technology, products and intellectual property related to certain wireless communications products.

SPEECH AND TELEPHONY PROCESSORS

DSP Group has developed two lines of speech and telephony processing chips: integrated digital TAD speech processors, which are designed for use in the consumer telephone market, and Voice over IP speech co-processors, which are designed for use in network telephony and video conferencing products.

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Both product lines are based upon our DSP core designs and incorporate our TrueSpeech speech compression algorithms.

INTEGRATED DIGITAL TAD SPEECH PROCESSORS

DSP Group's integrated digital TAD speech processors are currently incorporated in over 90 models of digital TADs from more than 40 different companies. These models include standalone digital TADs and integrated digital TADs, as well as facsimile machines, standalone speaker phones, hand-held devices and digital cordless telephones that contain digital TADs.

Our digital TAD speech processors are based on our PineDSPCore-Registered Trademark-, which is more fully described below. Our digital TAD speech processors use our TrueSpeech speech compression technology to provide high quality speech recording and playback. They incorporate the following speech and telephony technologies in various combinations:

| TECHNOLOGY | DESCRIPTION |
|--|---|
| Triple Rate Coder-TM- | Instructs the telephone answering system to decide automatically between better voice quality and longer recording time. |
| G.723.1 | Provides speech compression for Voice over IP and video conferencing over standard telephone lines. |
| Caller ID and Call Waiting Caller ID | Identifies to the party being called the telephone number of the calling party, whether or not the party being called is already engaged in another call. |
| Call Progress Tone Detection | Detects standard telephony signals during the progress of a telephone call. |
| DTMF Signaling | Detects and generates touch tone (DTMF) signals that comply with telephone industry frequency standards. |
| Full Duplex SpeakerPhone-TM- | Allows simultaneous two-way (full-duplex), hands-free operation of the telephone and suppresses and cancels acoustic and electrical echoes. |
| Speech Prompts | Provides the ability to stamp a message with a time and date and vocal operating instructions prompts. |
| Variable Speed Playback (FlexiSpeech-Registered Trademark-) | Permits playback of recorded speech at different speeds without distorting the natural sound of the speech. |
| Voice Operated Switch ("VOX") (Smart-Vox-Registered Trademark-) | Detects human speech and stops recording during periods of silence, thereby conserving available memory. |
| Alpha Least Cost Routing | Automatically chooses from a number of telephone service providers in |

("LCR")/Super LCR

order to select the lowest available rates.

Voice Recognition

Allows a user to operate a telephone or answering machine device by giving voice commands.

The first integrated digital TAD speech processors were introduced by DSP Group in 1989. Since then, we have shipped approximately 33 million units of speech processors to digital TAD suppliers, of which approximately 10.3 million were shipped in 1998. Digital TAD speech processor sales accounted for 72% of our total revenues in 1998.

In 1998, we introduced the D16000 family of highly integrated speech processors, which combine the components of a mixed signal system on a single chip. Each speech processor in the D16000 family contains a DSP core, converters that transform analog signals into digital signals and vice versa, and various signal amplifiers, all embedded on a single chip. In addition to implementing DSP algorithms, including compression, caller ID and speaker phone, these speech processors also perform tasks that would typically be handled by a separate microprocessor chip. We believe that the D16000 processors provide high value to telephony product vendors by eliminating the need for certain other electronic components and thus reducing materials and manufacturing costs.

We also introduced in 1998 the D6587 speech processor, which incorporates into one chip three major digital signal processing technologies: (1) the Triple Rate Coder, (2) voice recognition, and (3) Full Duplex SpeakerPhone. The D6587 can be used in telephones and hands-free car kits for mobile phones to provide voice dialing, digital recording and hands-free conversation.

In 1997, we developed an advanced speech compression technology called the Triple Rate Coder. Speech processors containing the Triple Rate Coder can record speech at three different compression rates, allowing for a tradeoff between recording quality and recording time: the higher the compression rate is, the higher the recording quality and the shorter the recording time will be. The three compression rates are as follows:

- Long recording time -- at this rate, 22 to 25 minutes of speech can be recorded on a four megabit flash memory device.
- High quality recording -- at this rate, approximately 10 minutes of speech can be recorded on a four megabit flash memory device. Speech quality is at its highest equaling that of a wired telephone conversation, overcoming the inferior clarity disadvantage of digital speech.
- Trade-off between long recording time and high quality recording -- at this rate, approximately 15 minutes of speech can be recorded on a four megabit flash memory device. Speech quality matches that provided by G.723.1, the speech compression algorithm contained in the International Telecommunications Union H.324 standard for video conferencing over standard telephone lines.

The following table sets forth certain characteristics and features of the primary digital TAD speech processors that we currently offer:

DSP GROUP'S TAD SPEECH PROCESSORS

| | D16559 | D16529 | D16329 | D6571 | D6587 | D6471 |
|--------------------------------------|-----------------|-----------------|--------|-----------------|-----------------|-------|
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Process Geometry (microns)..... | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Minutes Record, 4 Mbit Memory..... | 22-25, 10,15 | 22-25, 10,15 | 15-17 | 22-25, 10,15 | 22-25, 10,15 | 25-27 |
| Memory Type..... | Flash | Flash | Flash | Flash | Flash | Flash |
| Advanced Features: | | | | | | |
| Speech Prompts..... | Yes | Yes | Yes | Yes | Yes | Yes |
| Variable Speed Playback..... | Yes | Yes | -- | Yes | Yes | Yes |
| Full Duplex Speakerphone..... | Yes | -- | -- | Yes | Yes | Yes |
| Caller ID and Call Waiting Caller ID | Yes | Yes | -- | Yes | Yes | Yes |

| | | | | | | |
|--------------------------------------|-----|-----|-----|----|-----|----|
| Voice Recognition | -- | -- | -- | -- | Yes | -- |
| System On Chip-included peripherals: | | | | | | |
| Microcontroller..... | Yes | Yes | Yes | -- | -- | -- |
| Line Coder | Yes | Yes | Yes | -- | -- | -- |
| Speaker Coder..... | Yes | -- | -- | -- | -- | -- |
| Amplifiers..... | Yes | Yes | Yes | -- | -- | -- |

The following is a list of TAD manufacturers and resellers whose products incorporate our TAD speech processors:

TAD MANUFACTURERS AND RESELLERS

| TAD MANUFACTURERS | | TAD RESELLERS |
|-------------------|------------|-------------------|
| Alcatel | Maxon | Bell South |
| Ascom | Panasonic | Bosch Telecom |
| CCT Telecom | Philips | British Telecom |
| Daewoo | Sagem | France Telecom |
| D&B Electronics | Samsung | GE |
| Ericsson | Sanyo | German Telecom |
| Giant | Siemens | Loewe-Binatone |
| HPF Ascom | Smoothline | Southwestern Bell |
| I.N.T. Corp. | Sony | Swiss Telecom |
| Kinpo | Thomson | |
| L.G. Electronics | Tiptel | |
| Matra | Uniden | |

VOICE OVER IP SPEECH CO-PROCESSORS

Our Voice over IP speech co-processors were developed for use in conjunction with other microprocessors to transmit voice over public and private networks such as the Internet, frame relay networks, cable networks and other data networks and combined data/voice networks. "Voice over IP" refers to the transmission of voice signals over networks using the Internet Protocol (IP), which involves dividing the signals into numerous small data packets that are individually transmitted over the network and reassembled in the correct order at their destination. They also can be used to implement the speech component of video conferencing applications.

These speech co-processors take advantage of G.723.1, a speech compression algorithm that has been incorporated into various international communications standards, which is more fully discussed below, to provide cost-effective, high quality speech compression. The following table sets forth other features of the Voice over IP speech co-processors that we currently offer:

DSP GROUP'S VOICE OVER IP SPEECH CO-PROCESSORS

| | CT8016 | CT8020 | CT8021 |
|-------------------------------------|----------------|----------------|------------------------------------|
| DSP Core Design..... | PineDSPCore | OakDSPCore | OakDSPCore |
| Process Geometry (microns)..... | 0.5 | 0.6 | 0.5 |
| TrueSpeech Algorithm..... | 8.5, 6.3, 5.3, | 8.5, 6.3, 5.3, | 8.5, 6.3, 5.3, |
| Data Rate, Kilobits Per Second..... | 4.8 & 4.1 | 4.8 & 4.1 | 4.8 & 4.1 |
| ITU-T Standard Speech Coders..... | G.729A+B | G.723.1 | G.723.1, G.722, G.728, G.729A+B |

Features:

| | | | |
|--------------------------------------|-----|-----|-----|
| Full Duplex Speakerphone..... | Yes | Yes | Yes |
| Variable Speed Message Playback..... | Yes | -- | Yes |
| Full Duplex DSVD..... | Yes | Yes | Yes |
| Video Conferencing..... | -- | Yes | Yes |
| Internet Telephony..... | Yes | Yes | Yes |

FUTURE SPEECH AND TELEPHONY PROCESSORS

We are currently developing our next generation of integrated digital TAD speech processors and Voice over IP speech co-processors to include a number of enhancements and improvements.

First, we intend to design and manufacture our future digital TAD speech processors using a 0.35 micron CMOS technology, so that the conductive paths on the circuits inside these chips will be 0.35 microns wide. By reducing these line widths we can place more transistors in the same amount of space and as a result provide more power at the same cost. We expect that this design will increase our competitiveness in the price-sensitive TAD business.

Second, we intend to add new features to our next generation of digital TAD speech processors and Voice over IP speech co-processors. For example, we intend to enhance our integrated digital TAD speech processors with additional capabilities, including improved speech quality, full duplex speakerphone, advanced voice recognition and text to speech algorithms and our integrated 900 MHz spread spectrum processor. In addition, we intend to use the TeakLite-TM-DSP core, which is more powerful than our PineDSPCore and OakDSPCore-Registered Trademark-, to provide additional processing power for these new features.

Finally, we intend to continue to develop new speech and telephony processors for emerging communications applications. We also intend to use our high performance, dual MAC DSP TeakLite core for Voice over IP gateway applications.

DSP CORES

DSP Group has developed proprietary, DSP core designs that provide low-power, cost-effective solutions for current and emerging digital signal processing applications. Our DSP cores are incorporated in our own family of speech and telephony processors and also are licensed to more than 30 entities, including Adaptec, Fujitsu, Kawasaki, LSI Logic, NEC, Oki, Samsung Semi conductor, Inc., Seiko Epson, Siemens, Sony, Temic and VLSI Technology.

We currently offer four DSP cores--PineDSPCore, OakDSPCore, TeakDSPCore-TM-and PalmDSPCore.-TM- Together, they cover a wide range of applications, from low end applications, including digital TADs, hard disk controllers, low speed modems and Voice over IP applications, to high

performance applications such as digital subscriber line (DSL), third generation cellular communications, high speed modems, multimedia and Internet gateways.

Digital signal processing chips and software are being used more and more in high volume communication and computing products. We believe that our cores can provide cost-effective DSP solutions for chips used in these applications, because our cores are:

- Flexible. The DSP core designs are "soft core" designs, so they are -----
foundry independent and can be implemented on any of the various manufacturing processes used by different semiconductor fabrication facilities. The cores can also be produced by manufacturers in different geometries. Furthermore, universal design rules are used in the DSP core designs to allow easy implementation across multiple semiconductor process technologies.
- Efficient to design. The designs of our cores are highly efficient, -----

with variable data size of 16/20/24 bits, general purpose DSPs with adjacent modular RAM and ROM and general I/O blocks to provide for a flexible layout and design.

- Power efficient. Our cores operate at different voltages, ranging

from 5 volts down to 1.1 volts. The lower the voltage, the lower the power requirements.
- Inexpensive to manufacture. The DSP cores, which in the past could

only be used on processors designed for a 1.0 micron CMOS process, can now be implemented on 0.25 and 0.18 micron processes. We believe these size reductions in manufacturing can reduce the product cost, while increasing product performance.

The efficient processing, flexible design and scaleable memories of our DSP core designs allow for the development of smaller and lower cost DSP solutions and shorten the time to market for new products and product enhancements.

With each new core, we have added features and enhanced performance. Our first core, the PineDSPCore, was released in 1992 and was developed for use in our digital TAD speech processor products. In 1994, we introduced our OakDSPCore, an enhanced version of the PineDSPCore that, among other things, achieves a higher processing speed through improved architecture and includes an advanced, more efficient instruction set. The OakDSPCore is especially well-suited for use in personal communication products and higher level processing applications, such as digital cellular telephones, high bit rate modems, video telephone conferencing applications and DSVD modems, which send compressed voice and data signals at the same time over a regular telephone line. Algorithms that use the PineDSPCore instruction set can also be run on the OakDSPCore.

In 1998, we introduced the TeakDSPCore, the next generation DSP core. The TeakDSPCore is a family of two low power, cost effective cores: the TeakLite and the Teak. These cores contain two arithmetic units functioning in parallel, which improve the performance of a notable portion of the application that requires DSP technology. The TeakDSPCore is aimed at emerging applications in the digital cellular communications, including products implementing the Global System for Mobile communications (GSM), half-rate GSM, Time Division Multiple Access (TDMA) and Code Division Multiple Access (CDMA) standards. We also have targeted this core for use in advanced wired line modems, including those using the V.90 standard, products implementing emerging digital audio standards and formats such as AC3 and MPEG2, and Voice over IP and telecommunications products.

In 1998, we also introduced our new high performance PalmDSPCore, a family of three cores designed to cover a wide range of high performance applications, including third generation cellular communications, asynchronous digital subscriber lines (ADSL), high performance multimedia applications, cable modems, pooled modems and Internet gateways.

The following table shows a comparison of our DSP core designs:

DSP GROUP'S DSP CORE DESIGNS

| | PineDSPCore ----- | OakDSPCore ----- | TeakDSPCore ----- | PalmDSPCore ----- |
|---------------------------------|----------------------|---------------------|----------------------|----------------------|
| Word Length | 16 bit | 16bit | 16bit | 16/20/24 bit |
| Process Geometry (microns)..... | 0.5 | 0.35 | 0.25 | 0.2 |
| Performance | 40 MIPS | 65MIPS | 140-180 MIPS | 450 MIPS |
| Voltage | 5.0 V | 3.3V | 2.5V | 2.5V |
| Advanced Instruction Set..... | -- | Yes | Yes | Yes |

In addition to incorporating our DSP core designs in our speech and telephony processors, we also license them to third parties, together with advanced software tools, so that these licensees can incorporate our DSP core designs into their semiconductor chip products. These licenses are generally granted in exchange for an upfront license fee payment. This fee is generally recognized by us upon shipment of the deliverables for the core, provided that no significant vendor or post-contract support obligations remain outstanding and that collection of the resulting receivable is deemed probable. The licensees also pay a monthly support fee, which is typically paid for a period of one or two years, and ongoing per-unit royalties based on the number of units of products containing the core that are shipped by the licensee. The timing and amount of royalties that DSP receives from its core licensees depend on the timing of each licensee's product development and the degree of market acceptance of each licensee's products, neither of which are within our control. In 1998, royalties paid by four PineDSPCore and OakDSPCore licensees for shipment of products utilizing these cores increased from the previous year.

The following is a partial list of companies who have licensed our DSP core designs and representative applications for which they use our DSP core designs:

DSP CORE DESIGN LICENSES

| ----- LICENSEES ----- | ----- REPRESENTATIVE APPLICATIONS ----- |
|-----------------------------|---|
| Adaptec | Disk Drives |
| Atmel | ASIC, Communications |
| DSP Communications | Digital Cellular Telephones |
| Fujitsu | ASIC, ADSL, Communications |
| Harris Semiconductor | Communications and Multimedia |
| Hyundai | ASIC, Audio, Communications |
| Kawasaki | ASIC, Communications |
| Kenwood | Audio Products |
| LSI Logic | ASIC, Communications, DAB |
| Mitel | ASIC, Communications |
| National Semiconductors | Communications |
| NEC | ASIC, Communications |
| Oki | Communications |
| ROHM | ASIC, Communications |
| Samsung | ASIC, Communications and Multimedia |
| Seiko-Epson | ASIC, Communications |
| Siemens | Communications |
| Sony | Communications |

| | |
|-------------------|--------------------------|
| TDK Semiconductor | Modems |
| TEMIC | DAB, Communications |
| TSMC | ASIC Library |
| VLSI Technology | ASIC, Communications |
| Xemics | Low Voltage applications |
| Xicor | Programmable DSP |

In order to assist existing licensees of the PineDSPCore and OakDSPCore, and to enhance the attractiveness of these cores to potential licensees, we have entered into agreements with leading developers of semiconductor design and simulation software, including Cadence, Mentor Graphics and Synopsys. These companies have adapted certain of their software applications to support our PineDSPCore and OakDSPCore, enabling such software to be used to design and simulate semiconductor products containing these cores. In addition, a number of independent software vendors, including VoCal Technologies, Prairiecomm, and Enigma, have developed digital signal processing algorithms that operate on our PineDSPCore and OakDSPCore for a

variety of communications and multimedia applications. We believe that these developments make our DSP core designs more attractive to potential licensees. In addition, we believe that these software tools help to establish our PineDSPCore and the OakDSPCore as industry standards.

In 1998, XEMICS, a Swiss company and a leading manufacturer of low voltage medical devices such as hearing aids and pace makers, announced that it would license and implement TeakLite on a very low voltage library instruction set. Together with Xemics, we offer a design kit for low voltage applications (1.2V), by which potential licensees will license the TeakLite technology from DSP Group and the low voltage library from Xemics.

TRUESPEECH PRODUCTS

TrueSpeech is a family of high-quality, cost-effective speech compression technologies 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, we also have enhanced TrueSpeech for use in the computer telephony, personal computer and Voice over IP markets. We incorporate our TrueSpeech technology in our speech and telephony processors and also license TrueSpeech to computer telephony, personal computer and Voice over IP companies for inclusion in their products.

Our TrueSpeech technology has become one of the leading digital speech compression solutions in several markets. In the personal computer market, Microsoft has incorporated a TrueSpeech algorithm in Windows 95, Windows 98 and NT. In the audio and video telephone conferencing markets, TrueSpeech algorithms are used extensively, having been adopted by various international standards-setting organizations. In February 1995, the International Telecommunications Union established its G.723.1 standard for low bit rate speech compression, which incorporates the TrueSpeech 6.3 and 5.3 algorithms. In March 1997, the International Multimedia Teleconferencing Consortium, a nonprofit industry group, recommended the G.723.1 standard as a default low bit rate audio compression technology for all voice transmissions over the Internet and for conferencing products conforming to the International Telecommunication Union's H.323 standard for packet-based multimedia communications systems. G.723.1 is also part of the International Telecommunication Union's H.324 standard for video conferencing over standard telephone lines. Since its adoption and endorsement by the International Telecommunications Union and the International Multimedia Teleconferencing Consortium, the G.723.1 standard has gained considerable momentum in the video and audio conferencing industry.

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We believe that the principal advantages of TrueSpeech, as compared with other currently available digital speech compression technologies, are as follows:

- High Compression Ratio. The three versions of TrueSpeech currently

offered 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"), which is used in current generation telephone speech transmissions, and four to six times greater than the compression provided by Adaptive Differential PCM ("ADPCM"), which is 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. Our competitors have introduced other advanced speech algorithms that offer compression ratios comparable to the most advanced TrueSpeech algorithms, and several had submitted these algorithms to the ITU standards committee for evaluation for video telephones. However, 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.723.1 standard for video telephones. In independently conducted tests performed by Dynastat, Inc., a company specializing in the performance evaluation of voice communication systems, TrueSpeech 6.3 received a Mean Opinion Score of 3.98, while regular telephone quality is based upon a Mean Opinion Score of 4.0.

- 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 memory for storage and operation. Consequently, competing speech compression algorithms require larger, more expensive DSPs and result in higher cost solutions.

Our TrueSpeech licensees include, among others, 8x8, Analog Devices, Cirrus Logic, Creative Labs, Dialogic, IBM, Intel, Microsoft, Philips, Siemens, Smith Micro, Texas Instruments, Unisys, US Robotics, Winbond and White Pine Software. In addition, we have ported our TrueSpeech algorithms to certain DSP platforms offered by Analog Devices, Motorola and Texas Instruments, three leading merchant vendors of programmable DSP chips. To date, our royalties from TrueSpeech licenses contribute modestly to our overall revenues.

CORDLESS TELEPHONY

In the beginning of 1999, DSP Group acquired two integrated groups of engineers, one located in Israel and the other in the United States. These twenty-five engineers specialize in the design of integrated circuits for wireless communication. In addition, we acquired technology and products, including associated intellectual property, related to 900 Megahertz narrow-band cordless telephones (the transmissions between the handset and base unit of such telephones are at or near a frequency of 900 megahertz) and 900 Megahertz spread spectrum cordless telephones (the transmissions between the handset and base unit of such telephones are "spread" in a pseudorandom pattern over a range of frequencies).

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We intend to sell a cordless telephony solution consisting of two chips - --a baseband chip and an RF chip -- that will allow telephone vendors to build 900 megahertz cordless telephones with limited technical understanding, shortening the time it takes for the product to reach the market. We believe our recent acquisitions also will assist us in developing 2.4 gigahertz cordless telephones. In addition, we believe that the cordless telephony business will be synergistic with our existing digital signal processing business.

SALES, MARKETING AND DISTRIBUTION

We market and distribute our products through our direct sales and marketing organization, consisting of 27 employees, as well as through a network of distributors and independent manufacturers' representatives. A marketing and sales team located in our headquarters in Santa Clara, California and in Israel pursues business with our customers in North America and closely monitors new markets, trends and customer needs to shape our strategic decisions. In Japan, we operate from a marketing and support office in Tokyo and through Tomen Electronics, a local distributor. In the rest of Asia, we operate through sales representatives in Hong Kong, Singapore, South Korea and Taiwan. To handle sales and distribution in Europe, we operate a marketing and support office located in France and have

sales representatives in Denmark, Israel, Germany, Spain, Sweden and the United Kingdom. Our sales representatives and distributors are not subject to minimum purchase requirements and can cease marketing our products at any time. The loss of one or more representatives or their failure to renew agreements with us upon expiration could have an adverse effect on our business, financial condition and results of operations.

In 1998, 1997 and 1996 sales to Tomen Electronics comprised 45%, 33% and 17%, respectively, of total revenues. In 1996, sales to Samsung comprised 11% of total revenues.

Export sales accounted for 95%, 92% and 91% of our total revenues in 1998, 1997 and 1996, respectively. Due to our export sales, we are subject to the risks of conducting business internationally, including unexpected changes in regulatory requirements, fluctuations in exchange rates that could increase the price of our 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 our export sales are denominated in United States dollars. See Note 3 of the Notes to Consolidated Financial Statements of our Annual Report to Stockholders for the year ended December 31, 1998, for a summary of our operations within various geographic areas.

MANUFACTURING AND DESIGN METHODOLOGY

Since our products are based on our 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. Accordingly, all of our manufacturing occurs at independent foundries. We contract fabrication services for speech and telephony processors from Taiwan Semiconductor Manufacturing Company, Tower Semiconductor and Samsung. Under non-exclusive agreements, these independent foundries normally provide us with finished, packaged and tested speech processors at variable prices depending on the volume of units purchased. We customarily pay for fully-tested products meeting predetermined specifications. To ensure the integrity of quality assurance procedures, we develop detailed testing procedures and specifications for each product and require each foundry to use these procedures and specifications before shipping us finished products.

We intend 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, we are considering various alternative production sites. Our reliance on independent foundries involves a number of risks, including the foundries' achievement of acceptable manufacturing yields and allocation of capacity to us.

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In addition to our speech processors, digital TADs include various other components such as analog random access memory circuits (ARAMs), coders 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 our speech processors for digital TADs and other computer telephony products, which could in turn have a material adverse effect on our business, financial condition and results of operations.

COMPETITION

The markets in which we operate are extremely competitive and we expect that competition will increase. In each of our business activities, we face current and potential competition from competitors that have significantly greater financial, technical, manufacturing, marketing, sales and distribution resources and management expertise than we do. Our future prospects will depend greatly on our ability to successfully develop and introduce new products that are responsive to market needs. We cannot assure that we will be able to successfully develop or market any of these 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 us and our competitors. We

believe that we are 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. We believe that the continuing decline in prices of digital speech processors and silicon memory devices will close the cost gap between the analog and digital technology solution. Our principal competitors in the TAD speech processor market include ISD, Lucent Microelectronics, Macronix, Toshiba, Siemens 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. Our DSP core designs compete with companies such as Analog Devices, Atmel, Clarkspur Designs, SGS Thompson and Siemens, which license DSP platforms, and Analog Devices, Lucent Microelectronics, Motorola, and Texas Instruments, which sell their own complete general purpose 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. Our TrueSpeech algorithms compete with ADPCM, and the speech compression technologies used in GSM and VSELP protocols, 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 protocols, and Motorola, which developed the original VSELP protocols. 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 protocols 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 that 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 same markets for which our products are targeted.

Price competition in the markets in which we currently compete and propose to compete is intense and may increase, which could have a material adverse effect on our business, financial condition and results of operations. We have experienced and expect to continue to experience increased competitive pricing pressures for our digital TAD speech processors. During 1998, we were able to completely offset this decrease on an annual basis through manufacturing cost reductions. However, we cannot assure that we 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.

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RESEARCH AND DEVELOPMENT

We believe that continued timely development and introduction of new products is essential to maintain our competitive position. We currently conduct most of our product development effort in-house and at December 31, 1998 had a staff of 66 research and development personnel located in Israel. We also employ independent contractors to assist with certain product development and testing activities. We spent approximately \$10.2 million in 1998, \$8.4 million in 1997 and \$8.5 million in 1996 on research and development activities.

RELATIONSHIPS WITH AFFILIATED COMPANIES

We have a \$1.8 million equity investment in, and have entered into technology arrangements with, AudioCodes Ltd. ("AudioCodes"), an Israeli corporation primarily engaged in design, development, manufacturing and marketing of hardware and software products that enable simultaneous transmission of voice and data over networks such as Internet, ATM and Frame Relay. We currently own 29% of the capital stock of AudioCodes, a company formed in April 1993 by two of our former employees. Pursuant to an agreement between DSP Group and AudioCodes, DSP Group and AudioCodes have joint ownership of any speech compression technology developed by AudioCodes. We have established this relationship to complement our in-house product development efforts.

In July 1996, we invested \$2.0 million of cash for approximately 40% of the equity interest in Aptel Ltd. ("Aptel"), an Israeli company. In connection with the investment, we incurred a one-time write-off of acquired in-process technology of \$1.5 million. In October 1997, we invested approximately \$176,000 in convertible debentures issued by Aptel. In December 1997, we converted our debentures and Aptel's shareholders, including DSP Group, exchanged their shares in Aptel for common shares in Nexus Telecommunications Systems Ltd. ("Nexus"), an Israeli company registered and traded on the Nasdaq SmallCap Market. In April 1998, we sold all of our Nexus shares in a private transaction and realized a pre-tax one time gain on marketable equity securities of approximately \$1.1 million. This one time gain is included under "Other income (expenses)" in our consolidated statements of income for the year ended December 31, 1998.

LICENSES, PATENTS AND TRADEMARKS

We have been granted seven United States patents, one Canadian patent and one Israeli patent, and have seven patents pending in the United States, two patents pending in Japan, two patents pending in Israel and one patent pending in Europe. We actively pursue foreign patent protection in other countries of interest to us. Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. The status of patents involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure that any patent application filed by us will result in a patent being issued, or that our patents, and any patents that may be issued in the future, will afford adequate protection against competitors with similar technology; nor can we provide assurance that patents issued to us will not be infringed or designed around by others. In addition, the laws of certain countries in which our products are or may be developed, manufactured or sold, including Hong Kong, Japan and Taiwan, may not protect our products and intellectual property rights to the same extent as the laws of the United States.

We attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants, and through other security measures. Although we intend to protect our rights vigorously, we cannot provide 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 we have not been involved in any material patent or other intellectual property rights litigation to date, we cannot provide assurance that third parties will not assert claims against us with respect to existing or future products or that we will not need to assert claims against

third parties to protect our proprietary technology. For example, AT&T has asserted that G.723.1, 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. If litigation becomes necessary to determine the validity of any third party claims or to protect our proprietary technology, it could result in significant expense to us and could divert the efforts of our technical and management personnel, whether or not the litigation is determined in our favor. In the event of an adverse result in any litigation, we 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. We cannot provide assurance that we would be successful in developing non-infringing technology or that any licenses would be available on commercially reasonable terms.

We have been issued registered trademarks for the use of the PineDSPCore, OakDSPCore, TeakDSPCore, OCEM-Registered Trademark- and TrueSpeech trademarks. In addition, we applied for trademarks for Full Duplex SpeakerPhone, TeakLite, Triple Rate Coder, and PalmDSPCore.

While our ability to compete may be affected by our ability to protect our intellectual property, we believe that, because of the rapid pace of technological change in the industry, our technical expertise and ability to

innovate on a timely basis will be more important in maintaining our competitive position than protection of our intellectual property. We believe 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 our personnel, new product introductions and frequent product enhancements. Although we continue to implement protective measures and intend to defend our intellectual property rights, we cannot provide assurance that these measures will be successful.

BACKLOG

At December 31, 1998, our backlog was approximately \$8.7 million compared with approximately \$16.8 million at December 31, 1997. We include in our 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. Our business in digital TAD speech processors is characterized by short-term order and shipment schedules. Product orders in our 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 our sales for any future period.

EMPLOYEES

At December 31, 1998, we had 120 employees, including 66 in research and development, 27 in marketing and sales and 27 in corporate and administration and manufacturing coordination. Competition for personnel in the semiconductor, software and personal computer industries in general is intense. We believe that our future prospects will depend, in part, on our 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 our employees is represented by a collective bargaining agreement, nor have we ever experienced any work stoppage. We believe that our employee relations are good.

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FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY

We experience, and will continue to experience, significant fluctuations in sales and operating results from quarter to quarter. Our quarterly results fluctuate due to a number of factors:

- fluctuations in volume and timing of product orders;
- timing of recognition of license fees;
- level of per unit royalties;
- changes in demand for our products due to seasonal customer buying patterns and other factors;
- timing of new product introductions by us or our customers, licensees or competitors;
- changes in the mix of products sold by us;
- fluctuations in the level of sales by OEMs and other vendors of products incorporating our products; and
- general economic conditions, including the changing economic conditions in Asia.

Each of the above factors is difficult to forecast and thus could have a material adverse effect on our business, financial condition and results of operations.

Through 1999, we expect that revenues from our DSP core designs and TrueSpeech algorithms 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 our operating results. Our per unit royalties from licenses are totally dependent upon the success of our third party licensees in introducing products utilizing our technology and the success of those third party products in the marketplace. Per unit

royalties from TrueSpeech licensees have not been significant to date.

In addition, in the fourth quarter of 1998 and in the first quarter of 1999, we experienced a sharp decrease in product revenues as a result of the phasing out of an old line of digital TAD products, while shipments from a new product line are expected to begin in the second quarter of 1999.

OUR AVERAGE SELLING PRICES CONTINUE TO DECLINE

We have experienced a decrease in the average selling prices of our digital TAD speech processors, but have 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. However, we cannot guarantee that our on-going efforts will be successful or that they will keep pace with the anticipated, continuing decline in average selling prices.

WE DEPEND ON THE DIGITAL TAD MARKET WHICH IS HIGHLY COMPETITIVE

Sales of digital TAD products comprise a substantial portion of our product sales. Any adverse change in the digital TAD market or in our ability to compete and maintain our position in that market would have a material adverse effect on our business, financial condition and results of operations. The digital TAD market and the markets for our products in general are extremely competitive and we expect that competition will only increase. Our existing and potential competitors in each of our 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 we do. It is possible that we may one day be unable to respond to increased price competition for TAD speech processors or other products through the introduction of new products or reductions of manufacturing costs. This inability would have a material adverse effect on our business, financial condition and results of operations. Likewise, any significant delays by us in developing, manufacturing or shipping new or

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enhanced products would also have a material adverse effect on our business, financial condition and results of operations.

WE DEPEND ON REVENUES FROM A CURRENTLY UNSTABLE ASIAN MARKET

In 1997, we generated approximately \$19.9 million, or 39% of our total product sales, from sales to customers located in South Korea, Taiwan, Singapore and Hong Kong. However, in 1998, due to economic problems in some of these countries, most notably South Korea and Singapore, our product sales in this region decreased to \$10.9 million, or 22% of our total product sales.

The decline in sales from Southeast Asia countries resulted in a decrease in our backlog, but was partially offset by increased orders from Japan. If this negative economic trend in the Asian markets continues, it may result in a further decrease of our backlog in 1999. We cannot provide assurance that continued negative economic development in Asia will not have a material adverse effect on our future operating performance.

WE DEPEND ON INDEPENDENT FOUNDRIES TO MANUFACTURE OUR INTEGRATED CIRCUIT PRODUCTS

All of our integrated circuit products are manufactured by independent foundries. While these foundries have been able to adequately meet the demands of our increasing business, we are and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to us a sufficient portion of foundry capacity to meet our needs in a timely manner. To meet our increased wafer requirements, we have added additional independent foundries to manufacture our digital TAD speech processors. Our revenues could be materially and adversely affected should any of these foundries fail to meet our request for products due to a shortage of production capacity, process difficulties, low yield rates or financial instability.

WE DEPEND ON INTERNATIONAL OPERATIONS, PARTICULARLY IN ISRAEL

We are subject to the risks of doing business internationally, including:

- unexpected changes in regulatory requirements;
- fluctuations in the exchange rate for the U.S. dollar;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws;
- political and economic instability; and
- changes in diplomatic and trade relationships.

In particular, our principal research and development facilities are located in the State of Israel and, as a result, at December 31, 1998, 97 of our 120 employees were located in Israel, including all 66 of our research and development personnel. In addition, although DSP Group is incorporated in Delaware, a majority of our directors and executive officers are residents of Israel. Therefore, we are directly affected by the political, economic and military conditions to which Israel is subject.

Moreover, many of our expenses in Israel are paid in Israeli currency which subjects us to the risks of foreign currency fluctuations and to economic pressures resulting from Israel's generally high rate of inflation. The rate of inflation in Israel was 8.6% in 1998 and 7.0% in 1997. While substantially all of our sales and expenses are denominated in United States dollars, a portion of our expenses are denominated in Israeli shekels. Our primary expenses paid in Israeli currency are employee salaries and lease payments on our Israeli facilities. 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, sales and marketing expenses and general and administrative expenses. We cannot provide assurance that currency fluctuations, changes in the rate of inflation in Israel or any of the other factors mentioned above will not have a material adverse effect on our business, financial condition and results of operations.

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WE DEPEND ON THIRD PARTIES AND THEIR SUPPLIERS TO OBTAIN REQUIRED COMPLEMENTARY COMPONENTS

Some of the raw materials, components and subassemblies included in the products manufactured by our third party customers, which also incorporate our products, are obtained from a limited group of suppliers. Supply disruptions, shortages or termination of any of these sources could have an adverse effect on our business and results of operations due to the delay or discontinuance of orders for our products by customers until the other necessary components are available.

WE DEPEND UPON THE ADOPTION OF INDUSTRY STANDARDS BASED ON TRUESPEECH

Our prospects are partially dependent upon the establishment of industry standards for digital speech compression based on TrueSpeech algorithms in the computer telephony and Voice over IP markets. The continuing development of industry standards utilizing TrueSpeech algorithms would create an opportunity for us 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.723.1, which is predominately composed of a TrueSpeech algorithm, as the standard speech compression technology for use in video conferencing over public telephone lines. In March 1997, the International Multimedia Teleconferencing Consortium, a nonprofit industry group, recommended the use of G.723.1 as the default audio coder for all voice transmissions over the Internet or for IP applications for H.323 conferencing products.

THERE ARE RISKS ASSOCIATED WITH OUR ACQUISITION STRATEGY

DSP Group has pursued, and will continue to pursue, growth opportunities through internal development and acquisition of complementary businesses, products and technologies. We are unable to predict whether or when any prospective acquisition will be completed. The process of integrating an acquired business may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management's attention. We cannot provide assurance that we will be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate

acquired businesses into our operations or expand into new markets. Once integrated, acquisitions may not achieve comparable levels of revenues, profitability or productivity as the existing business of DSP Group or otherwise perform as expected. The occurrence of any of these events could harm our business, financial condition or results of operations. Additionally, future acquisitions may require substantial capital resources, which may require us to seek additional debt or equity financing.

PROTECTION OF OUR INTELLECTUAL PROPERTY IS LIMITED; RISKS OF INFRINGEMENT OF RIGHTS OF OTHERS

As is typical in the semiconductor industry, we have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. For example, AT&T has asserted that G.723.1, which is primarily composed of a TrueSpeech algorithm, includes certain elements covered by patents held by AT&T, and has requested that video conferencing manufacturers license the technology from AT&T. Other organizations including Lucent Microelectronics, NTT and VoiceCraft have raised public claims that they also have patents related to the G.723.1 technology.

If it appears necessary or desirable, we may try to obtain licenses under those patents or intellectual property rights that we are allegedly infringing. Although holders of these types of intellectual property rights commonly offer these licenses, we cannot assure that licenses will be offered or that terms of any offered licenses will be acceptable to us. Our failure to obtain a license for key intellectual property rights from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacturing of products utilizing the technology. We believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, results of operations, or cash flows.

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OUR BUSINESS COULD BE ADVERSELY AFFECTED BY YEAR 2000 READINESS ISSUES

During the next year, many software programs may not recognize calendar dates beginning in the Year 2000. This problem could force computers or machines that utilize date dependent software to either shut down or provide incorrect information. To address this problem, we have examined our computer and information systems and have contacted our primary processing vendors, suppliers and other third parties.

Although we believe that our products are Year 2000 compliant, undetected errors or defects may remain. Disruptions to our business or unexpected costs may arise because of undetected errors or defects in the technology used in our products. If we, or any of our key suppliers or customers, fail to mitigate internal and external Year 2000 risks, we may temporarily be unable to process transactions, manufacture products, send invoices or engage in similar normal business activities or we may experience a decline in sales, which could have a material adverse effect on our business, financial condition and results of operations. See the section labeled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report to Stockholders for more information.

OUR STOCK PRICE MAY BE VOLATILE

Announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results and general conditions in the highly dynamic industry in which we compete or the national economies in which we do business, and other factors could cause the price of our common stock to fluctuate, perhaps substantially. In addition, in recent years the stock market has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. These factors and fluctuations could have a material adverse effect on the market price of our common stock.

WE HAVE MADE FORWARD-LOOKING STATEMENTS IN THIS ANNUAL REPORT ON FORM 10-K

The information contained in this Annual Report on Form 10-K and in the other documents referenced herein contains forward-looking statements that

involve a number of risks and uncertainties. Forward-looking statements can be identified by the use of forward-looking terminology, including "believes," "expects," "may," "will," "should" or "anticipates," or the negative of these terms or other variations or comparable terminology, or by discussions of strategy that involve risks and certainties. Numerous factors, including economic and competitive conditions, timing and volume of incoming orders, shipment volumes, product margins, and foreign exchange rates, could cause actual results to differ materially from those described in these statements. These forward-looking statements are based on current expectations and we assume no obligation to update this information.

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ITEM 2. PROPERTIES.

DSP Group's operations in the United States are located in an approximately 15,700 square foot leased facility in Santa Clara, California. This facility houses our marketing and support, North American sales, operations, manufacturing coordination and administrative personnel. This facility is leased through December 1999. In August 1997, our subsidiary, DSP Group, Ltd. moved to a facility in Herzlia Pituach, Israel with approximately 27,000 square feet pursuant to a lease ending in May 2002. In September 1998, DSP Group, Ltd. leased an additional 9,400 square feet at its current facility in Herzlia Pituch, Israel, through November 2003. In August 1997, DSP Group, Ltd. signed an additional lease agreement for office space in Omer, located in the south of Israel, for 840 square feet through September 1999.

ITEM 3. LEGAL PROCEEDINGS.

On February 12, 1997, BEKA Electronic GmbH ("BEKA") commenced an action in the United States District Court for the Northern District of California against DSP Group. The action alleges breach of contract, breach of implied covenant of good faith and fair dealing and requests an accounting by us in connection with our termination of the Sales Representative Agreement between BEKA and us. The complaint seeks an unspecified amount of damages. The parties completed non-binding mediation in May 1998, but were unable to settle the case. Discovery in the case has been completed. Trial has been set for May 11, 1999. DSP Group believes the lawsuit to be without merit and intends to defend itself vigorously.

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

None.

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PART II

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

The information contained in the section labeled "Price Range of Common Stock" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

The information contained in the section labeled "Subsequent Events--Sale of Common Stock" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA.

The information contained in the section labeled "Selected Consolidated Financial Data" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

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

The information contained in the section labeled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RATE.

The information contained in the section labeled "Quantitative and Qualitative Disclosures About Market Risk" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements and related notes and independent auditors report in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 are incorporated herein by reference.

The information contained in the section labeled "Quarterly Data" in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

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

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The following table sets forth certain information with respect to the directors and executive officers of DSP Group:

| NAME | AGE | POSITION |
|--------------------------|-----|---|
| Igal Kohavi | 59 | Chairman of the Board |
| Eliyahu Ayalon | 56 | President, Chief Executive Officer and Director |
| Avi Basher | 42 | Vice President of Finance, Chief Financial Officer and Secretary |
| David Tolub | 48 | Vice President-- Sales |
| Gideon Wertheizer | 42 | Vice President-- Marketing |
| Samuel L. Kaplan (1) (2) | 62 | Director |
| Zvi Limon (2) | 40 | Director |
| Millard Phelps (1) (2) | 70 | Director |
| Yair Shamir (1) (2) | 53 | Director |
| Saul Shani (1) | 44 | Director |

(1) Member of the Compensation Committee

(2) Member of the Audit Committee

IGAL KOHAVI has been Chairman of the Board of DSP Group since September 1995. Dr. Kohavi has served since 1995 as Chairman of the Venture Funds of Dovrat-Sherm & Co. Ltd., an Israeli investment bank at which he formerly served as President from October 1994 to January 1996. Between March 1993 and October 1994, he served as Managing Director of Clal Electronic Industries Ltd. Dr. Kohavi also serves as a director of Mercury Interactive Corporation (Nasdaq: MERQ) ("Mercury Interactive"), a provider of client/server and web testing tools.

ELIYAHU AYALON joined DSP Group in April 1996 as President, Chief Executive Officer and Director. From May 1992 to April 1996, Mr. Ayalon served as

President and Chief Executive Officer of Mennen Medical Ltd., a developer and manufacturer of medical instruments and apparatus.

AVI BASHER joined DSP Group in October 1996 as Vice President of Finance and Chief Financial Officer. In January 1997, he was elected to serve as Secretary of DSP Group as well. Prior to joining DSP Group, Mr. Basher served from December 1992 to October 1996 as Chief Financial Officer of InterPharm Laboratories, Ltd., a healthcare biotechnology company.

DAVID TOLUB joined DSP Group in May 1998 as Vice President, Sales. Prior to joining DSP Group, Mr. Tolub served from September 1993 to May 1998 as Vice President, Marketing of NICE Systems, a provider of Computer Telephony Integrated (CTI) recording and quality measurement solutions.

GIDEON WERTHEIZER joined DSP Group in September 1990 as Project Manager of DSP Group's VLSI Design Center and became Vice President of the VLSI Design Center in August 1995. In November 1997, Mr. Wertheizer was appointed Vice President, Marketing of DSP Group.

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SAMUEL L. KAPLAN has been a Director of DSP Group since May 1993. Mr. Kaplan has been a partner in the law firm of Kaplan, Strangis and Kaplan, P.A. of Minneapolis, Minnesota, since October 1978. Mr. Kaplan also serves as a trustee of USP Real Estate Investment Trust, a real estate investment trust.

ZVI LIMON has been a Director of DSP Group since February 1999. Mr. Limon has served as Chairman of Limon Holdings Ltd., a consulting and investment advisory firm since 1993. He presently serves as a director of Eltek Ltd. (Nasdaq: ELTKF), a developer and manufacturer of PC boards.

MILLARD PHELPS has been a Director of DSP Group since July 1995. Mr. Phelps has been most recently associated with Hambrecht & Quist, an investment banking firm, where he served from 1984 to August 1997 as Advisory Director in the corporate finance area, advising on public and private financing matters. Mr. Phelps has worked in the semiconductor industry for more than 20 years at several manufacturing companies, including Texas Instruments Incorporated, Fairchild Corporation, Intersil Inc. and Synertek Inc. He currently serves as a director of Trident Microsystems, Inc., a designer, developer and marketer of integrated circuit graphics and multimedia products.

YAIR SHAMIR has been a Director of DSP Group since October 1996 and has served as President and Chief Executive Officer of VCON Telecommunications, Ltd., a developer and marketer of video conferencing systems, since February 1997. From July 1995 to February 1997, Mr. Shamir served as the Executive Vice President of The Challenge Fund-Etgar L.P., a venture capital firm. From January 1994 to July 1995, he served as Chief Executive Officer for Elite Industries, Ltd., a food products company. Mr. Shamir currently serves as a director of Mercury Interactive, Orckit Communications, Limited, a developer and manufacturer of local loop communications systems and VCon Telecommunications, Ltd.

SAUL SHANI has been a Director of DSP Group since February 1999. Mr. Shani has served since 1996 as Managing Director of Limon Holdings, Ltd., a consulting and investment advisory firm. He also has served as Chairman and Director of Global Village Telecom N.V., a private company engaged in providing satellite based telephony services, since 1998. From 1990 to 1996, Mr. Shani served as co-founder, CEO, Chairman, and Director of Sapiens International Corporation NV (Nasdaq: SPNSF), a provider of enterprise-wide solutions for software applications.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE.

Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), requires DSP Group's directors, executive officers and persons who own more than 10% of DSP Group's common stock (collectively, "Reporting Persons") to file reports of ownership and changes in ownership of DSP Group's common stock with the Securities and Exchange Commission and The Nasdaq Stock Market, Inc. Copies of these reports are also required to be delivered to DSP Group.

Except as set forth below, we believe, based solely on our review of the copies of such reports received or written representations from certain

Reporting Persons, that during the fiscal year ended December 31, 1998, all Reporting Persons complied with all applicable filing requirements, except for the following: Mr. Phelps inadvertently failed to report a sale of DSP Group's common stock on his Form 4 for the period of the sale; such sale was subsequently reported on a later Form 4.

ITEM 11. EXECUTIVE COMPENSATION.

COMPENSATION OF NAMED EXECUTIVE OFFICERS

The following table sets forth all compensation earned by DSP Group's Chief Executive Officer and each of the four other most highly compensated executive officers of DSP Group (including one former executive officer) (collectively, the "Named Executive Officers") for the years ended December 31, 1998, 1997 and 1996.

SUMMARY COMPENSATION TABLE

| NAME AND PRINCIPAL POSITION | YEAR | ANNUAL COMPENSATION | | LONG-TERM |
|---|------|---------------------|-----------------|--|
| | | SALARY (1) \$ | BONUS (2) \$ | COMPENSATION AWARDS SECURITIES UNDERLYING OPTIONS (#) |
| Eliyahu Ayalon Chief Executive Officer, President and Director | 1998 | \$294,952 | \$240,000 | 150,000 |
| | 1997 | 283,747 | 212,500 | 150,000 |
| | 1996 | 157,493 (3) | 72,000 | 160,000 |
| Igal Kohavi Chairman of the Board | 1998 | 294,630 | 240,000 | 150,000 |
| | 1997 | 280,620 | 212,500 | 150,000 |
| | 1996 | 250,000 | 72,000 | 140,000 |
| Avi Basher Vice President of Finance, Chief Financial Officer and Secretary | 1998 | 174,082 | 45,000 | 10,000 |
| | 1997 | 163,299 | 45,000 | 30,000 |
| | 1996 | 31,822 (4) | -- | 50,000 |
| David Tolub (5) Vice President -- Sales | 1998 | 110,859 (6) | -- | 50,000 |
| | 1997 | -- | -- | -- |
| | 1996 | -- | -- | -- |
| Gideon Wertheizer (7) Vice President -- Marketing | 1998 | 172,122 | 50,000 | 20,000 |
| | 1997 | 146,362 | 45,000 | 15,000 |
| | 1996 | -- | -- | -- |
| Amir Karni (8) Former Vice President, Research and Development | 1998 | 125,644 | 10,000 | 10,000 |
| | 1997 | 61,317 (9) | -- | 22,000 |
| | 1996 | -- | -- | -- |

- (1) The salaries of officers located in Israel include social benefit payments and car allowances.
- (2) DSP Group's executive officers are eligible for annual cash bonuses. Such bonuses are generally based upon achievement of corporate performance objectives determined by DSP Group's Compensation Committee. Bonuses are awarded by the Compensation Committee based upon individual, as well as corporate, performance. DSP Group pays bonuses in the year following that in which the bonuses were earned.
- (3) Represents Mr. Ayalon's salary from his appointment as Chief Executive Officer, President and Director of DSP Group in April 1996.
- (4) Represents Mr. Basher's salary from his appointment as Vice President of Finance, and Chief Financial Officer of DSP Group in October 1996.
- (5) Mr. Tolub was appointed an executive officer of DSP Group in May 1998.
- (6) Includes \$12,357 of commissions earned by Mr. Tolub in 1998.
- (7) Mr. Wertheizer was appointed an executive officer of DSP Group in November 1997.
- (8) Mr. Karni resigned as Vice President, Research and Development in November 1998.

(9) Represents Mr. Karni's salary from his appointment as Vice President of Research and Development of DSP Group in July 1997.

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OPTION GRANTS

The following table sets forth certain information with respect to stock options granted during 1998 to each of the Named Executive Officers. In accordance with the rules of the Securities and Exchange Commission, also shown below is the potential realizable value over the term of the option (the period from the grant date to the expiration date) based on assumed rates of stock appreciation of 5% and 10%, compounded annually. These amounts are based on certain assumed rates of appreciation and do not represent DSP Group's estimate of future stock price. Actual gains, if any, on stock option exercises will be dependent on the future performance of the DSP Group's common stock.

OPTION GRANTS IN 1998
INDIVIDUAL GRANTS (1)

| NAME | NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED (#) | % OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN 1998 | EXERCISE PRICE | EXPIRATION DATE | POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM | |
|-------------------|--|---|-------------------|--------------------|--|-------------|
| | | | | | 5% | 10% |
| Eliyahu Ayalon | 150,000 | 18.94% | \$18.563 | 07/02/05 | \$1,133,551 | \$2,641,655 |
| Igal Kohavi | 150,000 | 18.94% | 18.563 | 07/02/05 | 1,133,551 | 2,641,655 |
| Avi Basher | 10,000 | 1.26% | 18.875 | 08/03/05 | 76,840 | 179,070 |
| David Tolub | 50,000 | 6.31% | 19.50 | 05/27/05 | 396,923 | 924,999 |
| Gideon Wertheizer | 20,000 | 2.53% | 18.875 | 08/03/05 | 153,680 | 358,141 |
| Amir Karni | 10,000 | 1.26% | 18.875 | 08/03/05 | 76,840 | 179,070 |

(1) All options were granted pursuant to the 1991 Employee and Consultant Stock Plan.

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Option Exercises and Option Values

The following table sets forth information concerning option exercises during 1998 and the aggregate value of unexercised options as of December 31, 1998 held by each of the Named Executive Officers.

AGGREGATED OPTION EXERCISES IN 1998
AND OPTION VALUES AT DECEMBER 31, 1998

| NAME | AGGREGATE OPTION EXERCISES IN 1998 | | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 1998 | | VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT DECEMBER 31, 1998 (1) | |
|----------------|--|------------------------------|--|---------------|--|---------------|
| | SHARES ACQUIRED ON EXERCISE (#) | VALUE REALIZED (\$)(2) | EXERCISABLE | UNEXERCISABLE | EXERCISABLE | UNEXERCISABLE |
| Eliyahu Ayalon | -- | -- | 85,000 | 257,500 | \$423,594 | \$735,781 |
| Igal Kohavi | -- | -- | 177,500 | 252,500 | 719,219 | 686,406 |
| Avi Basher | 12,500 | \$146,945 | 11,250 | 53,750 | 115,313 | 543,438 |

| | | | | | | |
|-------------------|-------|--------|-------|--------|--------|--------|
| David Tolub | -- | -- | -- | 50,000 | -- | 68,750 |
| Gideon Wertheizer | 5,586 | 57,959 | 8,437 | 36,645 | 21,563 | 94,160 |
| Amir Karni | -- | -- | 6,874 | 25,126 | 20,193 | 64,432 |

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- (1) Calculated on the basis of the closing price of DSP Group's common stock as reported on the Nasdaq National Market on December 31, 1998 of \$20.875 per share, minus the exercise price.
 - (2) Calculated on the basis of the broker's reported sale price of DSP Group's common stock subject to the option, minus the exercise price.

EMPLOYMENT AGREEMENTS

The following Named Executive Officers have written employment agreements with DSP Group: Messrs. Ayalon, Basher and Kohavi.

In April 1996, Mr. Ayalon entered into an employment agreement with DSP Semiconductors, Ltd., DSP Group's wholly owned subsidiary in Israel ("DSP Semiconductors"), pursuant to which Mr. Ayalon is to serve as the President and Chief Executive Officer of DSP Group. The term of the agreement is indefinite. The agreement originally provided for a fixed monthly salary of NIS 47,000 (approximately U.S. \$15,000), which shall be adjusted monthly to the Consumer Price Index of Israel. In June 1997, the Board of Directors increased Mr. Ayalon's monthly salary to NIS 69,295 (approximately U.S. \$20,500). Mr. Ayalon also is entitled to an annual bonus, the amount of which is determined at the sole discretion of the Board of Directors. The agreement may be terminated by DSP Group or Mr. Ayalon, without cause (as defined in the agreement), upon six months advance written notice. Mr. Ayalon's employment agreement was amended in November 1997 to provide for the following:

- (i) Mr. Ayalon's base compensation shall be fixed at the commencement of each year, but shall not be subject to reduction during the term of the agreement;
- (ii) if Mr. Ayalon terminates the agreement without good reason or if DSP Group terminates the agreement for cause, then no further payments shall be made to Mr. Ayalon pursuant to the agreement and he shall be subject to a one-year prohibition against competition in addition to the customary prohibitions against disclosure of trade secrets;
- (iii) upon a change of control of DSP Group or if the agreement is terminated by Mr. Ayalon for good reason or by DSP Group without cause, then all rights of Mr. Ayalon under the agreement would continue for two years and all options held by Mr. Ayalon would accelerate and immediately vest and be exercisable in whole or in part at any time during the remaining two-year term of the agreement; and
- (iv) in the event of death or permanent disability of Mr. Ayalon, all options shall accelerate and immediately vest.

In February 1997, Mr. Basher entered into an employment agreement with DSP Semiconductors pursuant to which Mr. Basher is to serve as the Vice President of Finance and Chief Financial Officer of DSP Group. The term of the agreement is indefinite. The agreement provides for a fixed monthly salary of NIS 31,970 (approximately U.S. \$10,000), which shall be adjusted monthly to the Consumer Price Index of Israel. Mr. Basher also is entitled to an annual bonus, the amount of which is determined at the sole discretion of the Board of Directors. The agreement may be terminated by DSP Semiconductors or Mr. Basher, without cause (as defined in the agreement), upon three months advance written notice.

In June 1997, Mr. Kohavi entered into an employment agreement with DSP Semiconductors pursuant to which Mr. Kohavi is to serve as the Chairman of the Board of Directors of DSP Group. The term of the agreement is indefinite. The agreement provided for a fixed monthly salary of NIS 69,295 (approximately U.S. \$20,500), which shall be adjusted monthly to the Consumer Price Index of Israel. Mr. Kohavi also shall be entitled to an annual bonus, the amount of which is determined at the sole discretion of the Board of Directors. The agreement may be terminated by DSP Group or Mr. Kohavi, without cause (as defined in the agreement), upon six months advance written notice. Mr. Kohavi's employment agreement was amended in November 1997 to provide for the following: (i) Mr. Kohavi's base compensation shall be fixed at the commencement of each year, but shall not be subject to reduction during the term of the agreement; (ii) if Mr. Kohavi terminates the agreement without good reason or if DSP Group terminates the agreement for cause, then

no further payments shall be made to Mr. Kohavi pursuant to the agreement and he shall be subject to a one year prohibition against competition in addition to the customary prohibitions against disclosure of trade secrets; (iii) upon a change of control of DSP Group or if the agreement is terminated by Mr. Kohavi for good reason or by DSP Group without cause, then all rights of Mr. Kohavi under the agreement would continue for two years and all options held by Mr. Kohavi would accelerate and immediately vest and be exercisable in whole or in part at any time during the remaining two-year term of the agreement; and (iv) in the event of death or permanent disability of Mr. Kohavi, all options shall accelerate and immediately vest.

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COMPENSATION OF DIRECTORS

Directors who are employees of DSP Group do not receive any additional compensation for their services as directors. Directors who are not employees of DSP Group receive an annual retainer of \$20,000, payable in quarterly installments of \$5,000 each. The retainer contemplates attendance at four Board of Director meetings per year. Additional Board of Directors meetings of a face-to-face nature are compensated at the rate of \$500 per meeting. In addition, committee meetings of a face-to-face nature or on a telephonic basis are compensated at the rate of \$500 per meeting. All directors are reimbursed for expenses incurred in connection with attending Board and committee meetings.

Each outside director of DSP Group is also entitled to participate in the 1993 Director Option Plan (the "Director Option Plan"). The Director Option Plan provides for the grant of non-statutory options to non-employee directors of DSP Group. The Director Option Plan is designed to work automatically; however, to the extent administration is necessary, it will be provided by the Board of Directors. The Director Option Plan provides that each eligible director is granted an option to purchase 15,000 shares of DSP Group common stock under the Director Option Plan on the date on which he or she first becomes a director of DSP Group. In addition, on the same date, each new director is granted an option to purchase 10,000 shares of common stock under the 1991 Employee and Consultant Stock Plan (the "1991 Stock Plan"). Thereafter, each outside director is granted an option to purchase 5,000 additional shares of common stock (a "Subsequent Option") on January 1 of each year if, on such date, he or she shall have served on DSP Group's Board of Directors for at least six months. In addition, an option to purchase 5,000 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 of Directors on which he or she shall have served as a chairperson for at least six months.

On January 2, 1998, each of Messrs. Kaplan, Phelps and Shamir were granted Subsequent Options to purchase up to 5,000 shares of DSP Group common stock, at an exercise price of \$19.25 per share, under the Director Option Plan.

On January 2, 1998, Mr. Kaplan was granted a Committee Option to purchase up to 5,000 shares of DSP Group common stock, at an exercise price of \$19.25 per share, under the Director Option Plan.

On July 2, 1998 each of Messrs. Ayalon and Kohavi were granted options to purchase up to 150,000 shares of DSP Group common stock, at an exercise price of \$18.5625, under the 1991 Stock Plan.

On January 4, 1999, each of Messrs. Kaplan, Phelps and Shamir were granted Subsequent Options to purchase up to 5,000 shares of DSP Group common stock, at an exercise price of \$20.375 per share, under the Director Option Plan.

On January 4, 1999, each of Messrs. Kaplan and Phelps were granted Committee Options to purchase up to 5,000 shares of DSP Group common stock, at an exercise price of \$20.375 per share, under the Director Option Plan.

On February 5, 1999, the date on which they were appointed as directors of DSP Group, each of Messrs. Limon and Shani were granted an option to purchase up to 15,000 shares of DSP Group common stock, at an exercise price of \$13.625 per share under the Director Option Plan. On the same date, each of Messrs. Limon and Shani also were granted an option to purchase up to 10,000 shares of DSP Group common stock, at an exercise price of \$13.625 per share, under the 1991 Stock Plan.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of DSP Group currently consists of Messrs. Kaplan, Phelps, Shamir and Shani; Mr. Kaplan serves as its Chairman. No member of this committee is a present or former

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officer or employee of DSP Group or any of its subsidiaries. Other than Mr. Kohavi, no executive officer of DSP Group served on the board of directors or compensation committee of any entity which has one or more executive officers serving as a member of DSP Group's Board of Directors or Compensation Committee. Mr. Kohavi serves as the Chairman of the Board of VCON Telecommunications, Ltd., a public company listed on the Nouveau Marcheand located in Israel, for which Mr. Shamir serves as President and CEO.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

NOTWITHSTANDING ANYTHING TO THE CONTRARY SET FORTH IN ANY OF DSP GROUP'S PREVIOUS FILINGS UNDER THE SECURITIES ACT OF 1933 OR THE EXCHANGE ACT THAT MIGHT INCORPORATE FUTURE FILINGS, INCLUDING THIS ANNUAL REPORT ON FORM 10-K, IN WHOLE OR IN PART, THE FOLLOWING REPORT AND THE STOCK PERFORMANCE GRAPH THAT FOLLOWS SHALL NOT BE DEEMED TO BE INCORPORATED BY REFERENCE INTO ANY SUCH FILINGS.

COMPENSATION POLICY. DSP Group's compensation policy, as established by the Compensation Committee, states that the executive officers' total annual cash compensation should vary with the performance of DSP Group and that long-term incentives awarded to such officers should be aligned with the interest of DSP Group's stockholders. DSP Group has designed its executive compensation program to attract and retain executive officers who will contribute to DSP Group's long-term success, to reward executive officers who contribute to DSP Group's financial performance and to link executive officer compensation and stockholder interests through the grant of stock options under the 1991 Employee and Consultant Stock Plan (the "1991 Stock Plan").

Compensation of DSP Group's executive officers consists of three principal components: salary, bonus and long-term incentive compensation consisting of stock option grants.

SALARY. The base salaries of DSP Group's executive officers are reviewed annually and are set by the Compensation Committee. When setting base salary levels, in a manner consistent with the Compensation Committee's policy outlined above, the Committee considers competitive market conditions for executive compensation, DSP Group's performance and the performance of the individual executive officer.

BONUS. For the fiscal year ended December 31, 1998, the Compensation Committee evaluated the performance of, and set the bonuses payable to, the Chief Executive Officer and the other executive officers of the Company. The performance factors utilized by the Compensation Committee in determining whether bonuses should be awarded to the Company's executive officers included the following: (1) increased sales of DSP Group's products and increased profitability of DSP Group during fiscal 1998; (2) the officer's overall individual performance in his position and his relative contribution to DSP Group's performance during the year; and (3) the desire of the Board of Directors to retain the executive officer in the face of considerable competition for executive talent within the industry. The Board of Directors or the Compensation Committee in the future may modify the foregoing criteria or select other performance factors with respect to bonuses paid to executive officers for any given fiscal year.

LONG-TERM INCENTIVE COMPENSATION. DSP Group believes that stock option grants (1) align executive officer interests with stockholder interests by creating a direct link between compensation and stockholder return, (2) give executive officers a significant, long-term interest in DSP Group's success, and (3) help retain key executive officers in a competitive market for executive talent.

The 1991 Stock Plan authorizes the Board, or a committee thereof, to grant stock options to employees and consultants of DSP Group, including the executive officers. Stock option grants are made from time to time to executive officers whose contributions have or will have a significant impact on DSP Group's long-term performance. DSP Group's determination of whether

stock option grants are appropriate is based upon individual performance measures established for each individual on an annual

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basis. Options are not necessarily granted to each executive officer during each year. Generally, options granted to executive officers vest as to 25% of the grant on the first anniversary of the date of grant with the remaining options vesting quarterly over the next three years and expire five years from the date of grant. Details on stock options granted to certain executive officers in 1998 are provided in the table entitled "Option Grants in 1998."

COMPENSATION OF CHIEF EXECUTIVE OFFICER. The Board of Directors considered the following factors in evaluating the performance of, and setting the bonus compensation for, Mr. Ayalon, DSP Group's Chief Executive Officer and President since April 1996: the increase in the net income of DSP Group from the prior year, DSP Group's stock price and the time and effort that Mr. Ayalon individually applied in connection with the execution of his duties. The Compensation Committee believes that the salary, bonus and long-term incentive compensation paid to Mr. Ayalon for the fiscal year ended December 31, 1998 were appropriate based on the above criteria.

COMPENSATION POLICY REGARDING DEDUCTIBILITY. Section 162(m) of the Internal Revenue Code, enacted in 1993, generally disallows a tax deduction to publicly held companies for compensation exceeding \$1 million paid to certain of the corporation's executive officers. The limitation applies only to compensation which is not considered to be performance-based. The non-performance based compensation to be paid to DSP Group's executive officers in 1998 did not exceed the \$1 million limit per officer. The 1991 Stock Plan is structured so that any compensation deemed paid to an executive officer in connection with the exercise of option grants made under such plan will qualify as performance-based compensation which will not be subject to the \$1 million limitation. The Compensation Committee currently intends to limit the dollar amount of all other compensation payable to DSP Group's executive officers to no more than \$1 million. The Compensation Committee is aware of the limitations imposed by Section 162(m), and the exemptions available therefrom, and will address the issue of deductibility when and if circumstances warrant, and may use such exemptions in addition to the exemption contemplated under the 1991 Stock Plan.

Submitted by the Compensation Committee:

Samuel L. Kaplan
Millard Phelps
Yair Shamir
Saul Shani

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STOCK PERFORMANCE GRAPH

The graph below compares the cumulative total stockholder return on DSP Group's common stock with the cumulative total return on the Standard & Poor's 500 Index and Standard & Poor's Technology Sector Index. The period shown commences on February 11, 1994, the date that DSP Group's common stock was registered under Section 12 of the Exchange Act, and ends on December 31, 1998, the end of DSP Group's last fiscal year. The graph assumes an investment of \$100 on February 11, 1994, and the reinvestment of any dividends.

The comparisons in the graph below are based upon historical data and are not indicative of, nor intended to forecast, future performance of DSP Group's common stock.

TOTAL RETURN TO STOCKHOLDERS
FEBRUARY 11, 1994 TO DECEMBER 31, 1998

Research Data Group

Peer Group Total Return Worksheet

Dsp Group (DSPG)

CUMULATIVE TOTAL RETURN

| | 2/11/94 | 3/94 | 6/94 | 9/94 | 12/94 | 3/95 | 6/95 | 9/95 | 12/95 | 3/96 |
|-----------------------|---------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| DSP GROUP, INC. | \$100 | \$116 | \$### | \$158 | \$139 | \$163 | \$179 | \$127 | \$ 82 | \$ 89 |
| S&P 500 | 100 | 93 | 93 | 98 | 98 | 108 | 118 | 127 | 135 | 142 |
| S&P TECHNOLOGY SECTOR | 100 | 99 | 95 | 104 | 111 | 125 | 154 | 163 | 160 | 169 |

CUMULATIVE TOTAL RETURN

| | 6/96 | 9/96 | 12/96 | 3/97 | 6/97 | 9/97 | 12/97 | 3/98 | 6/98 | 9/98 | 12/98 |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| DSP GROUP, INC. | \$ 66 | \$ 59 | \$ 61 | \$ 66 | \$107 | \$280 | \$143 | \$137 | \$141 | \$105 | \$149 |
| S&P 500 | 148 | 153 | 166 | 170 | 200 | 215 | 221 | 252 | 260 | 234 | 284 |
| S&P TECHNOLOGY SECTOR | 183 | 201 | 227 | 229 | 279 | 326 | 286 | 346 | 375 | 369 | 495 |

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

The following table sets forth certain information known to DSP Group with respect to the beneficial ownership of DSP Group's common stock as of March 1, 1999, by (1) each stockholder known to DSP Group to own beneficially more than 5% of the DSP Group's common stock; (2) each of DSP Group's directors; (3) the Named Executive Officers (including one former executive officer) determined for the fiscal year ended December 31, 1998; and (4) all directors and executive officers of DSP Group as a group.

| NAME OF BENEFICIAL OWNER | SHARES BENEFICIALLY OWNED (1) | APPROXIMATE PERCENT BENEFICIALLY OWNED (2) |
|---|----------------------------------|---|
| Magnum Technology, Ltd. c/o Rothschild Corporate Fiduciary Services, Ltd. P.O. Box 472 St. Peter's House, Le Bordage St. Peter Port, Guernsey Channel Islands GY1 6AX (3)..... | 2,896,500 | 24.90% |
| Loomis, Sayles & Company, L.P. One Financial Center Boston, Massachusetts 02111 (4)..... | 450,800 | 3.88% |
| Mellon Bank Corporation One Mellon Bank Center Pittsburgh, Pennsylvania 15258 (5)..... | 537,300 | 4.62% |
| Samuel L. Kaplan (6)..... | 78,188 | * |
| Zvi Limon | * | * |
| Millard Phelps (7)..... | 13,167 | * |
| Yair Shamir (8)..... | 11,667 | * |
| Saul Shani | * | * |
| Eliyahu Ayalon (9)..... | 104,133 | * |
| Avi Basher (10)..... | 20,242 | * |
| Igal Kohavi (11)..... | 219,960 | 1.86% |
| David Tolub | 357 | * |
| Gideon Wertheizer (12)..... | 12,997 | * |
| Amir Karni | * | * |
| All directors and executive officers as a group (11 persons) (13)..... | 460,711 | 3.86% |

* Less than 1%

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- (1) To DSP Group's knowledge, except as set forth in the footnotes to this table, and subject to applicable community property laws, each person named in this table has sole voting and investment power with respect to the shares set forth opposite such person's name.
- (2) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of DSP Group's common stock, subject to options currently exercisable or exercisable on or before April 30, 1999, are deemed outstanding for computing the percentage of the person holding such options, but are not deemed outstanding for computing the percentage of any other person. Percentages are based on 11,633,420 shares of DSP Group's common stock outstanding as of March 1, 1999.
- (3) Magnum Technology, Ltd. ("Magnum") filed Amendment No. 1 to a Schedule 13D, dated February 19, 1999, with the Securities and Exchange Commission on behalf of itself. Magnum reported sole voting and dispositive power over 2,896,500 shares.
- (4) Loomis, Sayles & Company, L.P. ("Loomis") filed a Schedule 13G, dated February 10, 1999, with the Securities and Exchange Commission on behalf of itself. Loomis reported sole voting power over 375,400 shares and shared dispositive power over 450,800 over shares.
- (5) Mellon Bank Corporation ("Mellon Bank") filed a Schedule 13G, dated February 5, 1999, with the Securities and Exchange Commission on behalf of itself. Mellon Bank reported sole voting power over 492,900 shares, sole dispositive power over 497,100 shares and shared dispositive power over 40,200 shares.
- (6) Includes 22,520 shares held of record by the Kaplan, Strangis and Kaplan, P.A. Profit Sharing Trust FBO Samuel L. Kaplan. Also includes 34,668 shares of DSP Group's common stock, subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (7) Includes 13,167 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (8) Includes 11,667 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (9) Includes 100,000 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (10) Includes 19,375 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (11) Includes 217,500 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (12) Includes 12,244 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.
- (13) See footnotes (6) through (12). Includes 408,621 shares of DSP Group's common stock subject to options which are currently exercisable or will become exercisable on or before April 30, 1999.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

OTHER TRANSACTIONS

DSP Group entered into a consulting agreement, date as of June 29, 1998, with Mr. Phelps, an outside director of DSP Group. Pursuant to the terms of the agreement, from May 1998 through December 1998, Mr. Phelps was to provide advice to DSP Group's Chairman of the Board regarding identifying potential merger and acquisition candidates. The agreement provided that Mr. Phelps be paid \$4,000 per month for his services.

On February 2, 1999, DSP Group entered into a stock purchase agreement with Magnum Technologies, Ltd., an international investment fund ("Magnum"), in which DSP Group issued and sold 2,300,000 new shares of DSP Group common stock to Magnum. Based in part on Magnum's representations, the transaction was exempt from the registration requirements of the Securities Act of 1933 according to Section 4(2) of the Securities Act. These shares, representing 19.6% of DSP Group's outstanding common stock at the time of the transaction, were issued for a price of \$15 per share, or an aggregate of \$34.5 million in total net proceeds to DSP Group. As part of the agreement, Magnum may acquire additional shares of DSP Group in the open market, but may not bring its total holdings to more than 35% of DSP Group's outstanding shares of common stock. Furthermore, Magnum has agreed not to sell any of the DSP Group shares of common stock it purchased without the prior written consent of DSP Group for a period of one year following the date of this transaction, and also to restrict its sales of the shares for an additional six-month period under Rule 144(e)(i) of the Securities Act of 1933. Additionally, DSP Group has invited Magnum to appoint two new directors to the Board of Directors, bringing the total number of members of the Board of Directors to seven.

DSP Group has entered into indemnification agreements with each of its directors and executive officers. Such agreements require DSP Group to indemnify such individuals to the fullest extent permitted by Delaware law.

All future transactions between DSP Group and its officers, directors, principal stockholders and affiliates will be approved by a majority of the Board of Directors, including a majority of the disinterested, non-employee directors on the Board of Directors, and will be on terms no less favorable to DSP Group than could be obtained from unaffiliated third parties.

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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 consolidated financial statements and related notes and auditor's report are included in DSP Group's Annual Report to Stockholders for the year ended December 31, 1998 and are incorporated into this Form 10-K by reference.

DESCRIPTION

Consolidated Balance Sheets as of December 31, 1998 and 1997

Consolidated Statements of Income for the years ended December 31, 1998, 1997 and 1996

Consolidated Statements of Stockholders' Equity for the years ended December 31, 1998, 1997 and 1996

Consolidated Statements of Cash Flows for the years ended December 31, 1998, 1997 and 1996

Notes to Consolidated Financial Statements

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 43) |
| Consent of Ernst & Young LLP, Independent Auditors | Exhibit 23.1 (included at page 42) |

All other schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or the related notes incorporated into this Form 10-K by reference to DSP Group's Annual Report to Stockholders for the year ended December 31, 1998.

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 | Amendment to Registrant's Bylaws, dated March 30, 1995 (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). |
| 3.4 | Certificate of Determination of Preference of Series A Preferred Stock of the Registrant, filed with the Secretary of State of the State of Delaware on June 6, 1997 (filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on June 6, 1997). |
| 3.5 | Amendment to Registrant's Bylaws, dated November 3, 1997 (filed as Exhibit 3.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference.) |
| 3.6 | Specimen Rights Certificate (filed as Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed on June 6, 1997). |
| 3.7 | Amended and Restated Rights Agreement, dated as of November 9, 1998, between the Registrant and Norwest Bank Minnesota, N.A., as Rights Agent. |
| 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 | 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). |

- 10.6 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).
 - 10.7 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).
 - 10.8 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).
 - 10.9 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).
 - 10.10 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 (filed as Exhibit 10.24 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated herein by reference).
 - 10.11 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 (filed as Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated herein by reference).
 - 10.12 Employment Agreement, dated February 24, 1997, by and between the Registrant and Avi Basher (filed as Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated herein by reference).
 - 10.13 Lease, dated November 28, 1996, by and between DSP Semiconductors Ltd. and Gav-Yam Lands Company Ltd., relating to the property located on Shenkar Street, Herzlia Pituach, Israel (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997, and incorporated herein by reference).
 - 10.14 Agreement, dated August 18, 1997, by and between DSP Semiconductors Ltd. and Aptel Ltd. (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997, and incorporated herein by reference).
 - 10.15 Employment Agreement with Igal Kohavi, dated as of June 1, 1997 (filed as Exhibit 10.24 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
 - 10.16 CompactRISC Technology License Agreement, dated as of September 29, 1997, by and between DSP Semiconductors Ltd. and National Semiconductor Corporation (filed as Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
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- 10.17 Amendment to Employment Agreement with Eliyahu Ayalon, dated as of November 3, 1997 (filed as Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
 - 10.18 Amendment to Employment Agreement with Igal Kohavi, dated as of November 3, 1997 (filed as Exhibit 10.27 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
 - 10.19 Amendment to 1993 Directors Stock Option Plan, as adopted November 3, 1997 (filed as Exhibit 10.28 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
 - 10.20 Separation and Consulting Agreement between the Registrant and Martin M. Skowron, dated May 31, 1998 (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
 - 10.21 Consulting Agreement between the Registrant and Millard Phelps, dated as of June 29, 1998 (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
 - 10.22 Lease, dated September 13, 1998, between DSP Group, Ltd. and Bayside Land Corporation Ltd., relating to the property located on Shenkar Street, Herzlia Pituach, Israel.
 - 10.23 1998 Non-Officer Employee Stock Option Plan.
 - 11.1 Statements regarding computation of per share earnings (included at page 40).
 - 13.1 Portions of the Annual Report to Stockholders for the year ended December 31, 1998.
 - 21.1 Subsidiaries of DSP Group (included at page 41).
 - 23.1 Consent of Ernst & Young LLP, Independent Auditors (included at page 42).
 - 27.1 Financial Data Schedule

(b) Reports on Form 8-K in Fourth Quarter.

The Company did not file any reports on Form 8-K during the three months ended December 31, 1998.

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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, 1999

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.

| SIGNATURE | TITLE | DATE |
|--|--|----------------|
| ----- /s/ Igal Kohavi ----- Igal Kohavi | Chairman of the Board | March 31, 1999 |
| ----- /s/ Eliyahu Ayalon ----- Eliyahu Ayalon | President, Chief Executive Officer and Director (Principal Executive Officer) | March 31, 1999 |
| ----- /s/ Avi Basher ----- Avi Basher | Vice President of Finance, Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer) | March 31, 1999 |
| ----- /s/ Samuel L. Kaplan ----- Samuel L. Kaplan | Director | March 31, 1999 |
| ----- /s/ Zvi Limon ----- Zvi Limon | Director | March 31, 1999 |
| ----- /s/ Millard Phelps ----- Millard Phelps | Director | March 31, 1999 |
| ----- /s/ Yair Shamir ----- Yair Shamir | Director | March 31, 1999 |
| ----- /s/ Saul Shani ----- Saul Shani | Director | March 31, 1999 |

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Exhibit 11.1

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

| | YEAR ENDED DECEMBER 31, | | |
|--|-------------------------|----------|---------|
| | 1998 | 1997 | 1996 |
| Numerator: | | | |
| Net income..... | \$14,415 | \$11,034 | \$5,979 |
| | ----- | ----- | ----- |
| Denominator: | | | |
| Weighted average number of common shares outstanding during the period used to compute basic earnings per share | 9,768 | 9,736 | 9,510 |
| | ----- | ----- | ----- |
| Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock)..... | 248 | 467 | 71 |
| | ----- | ----- | ----- |
| Weighted average number of shares of common stock used to compute diluted earnings per share..... | 10,016 | 10,203 | 9,581 |
| | ----- | ----- | ----- |
| Basic net income per share..... | \$1.48 | \$1.13 | \$0.63 |
| | ----- | ----- | ----- |
| Diluted net income per share..... | \$1.44 | \$1.08 | \$0.62 |
| | ----- | ----- | ----- |

Exhibit 21.1

LIST OF SUBSIDIARIES

| | Name of Subsidiary | Jurisdiction of Incorporation |
|----|-----------------------------|-------------------------------|
| 1. | Nihon DSP K.K. | Japan |
| 2. | DSP Group Ltd. | Israel |
| 3. | DSP Group Europe SARL | France |
| 4. | Voicecom Ltd. | Israel |
| 5. | RF Integrated Systems, Inc. | Delaware, U.S. |

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 25, 1999 (except for Note 9, as to which the date is February 18, 1999), included in the 1998 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, 33-87390, 333-53129 and 333-69289) pertaining to the 1991 Employee and Consultant Stock Plan, the 1991 DSP Group, Inc. Israeli Stock Option Plan, the 1993 Director Stock Option Plan, the 1993 Employee Stock Purchase Plan and the 1998 Non-Officer Employee Stock Option Plan, of our report dated January 25, 1999 (except for Note 9, as to which the date is February 18, 1999), with respect to the consolidated financial statements and schedule incorporated herein by reference or included in this Annual Report (Form 10-K) for the year ended December 31, 1998.

/s/ Ernst & Young LLP

Palo Alto, California
March 30, 1999

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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, 1996: | | | | |
| Allowance for doubtful accounts | 162 | 60 | 151 (1) | 71 |
| Sales returns reserve | 281 | 245 | 149 (2) | 377 |
| Year ended December 31, 1997: | | | | |
| Allowance for doubtful accounts | 71 | 60 | 61 (1) | 70 |
| Sales returns reserve | 377 | 345 | 600 (2) | 122 |
| Year ended December 31, 1998: | | | | |
| Allowance for doubtful accounts | 70 | 10 | - | 80 |
| Sales returns reserve | 122 | - | - | 122 |

- (1) Write-offs of uncollectible amounts
(2) Sales returns applied against revenue

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DSP GROUP, INC.
and
NORWEST BANK MINNESOTA, N.A.,

Rights Agent
RIGHTS AGREEMENT

Dated as of June 5, 1997

Amended and Restated as of November 9, 1998

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RIGHTS AGREEMENT

RIGHTS AGREEMENT, dated as of June 5, 1997, amended and restated as of November 9, 1998 (the "Agreement"), between DSP Group, Inc., a Delaware corporation (the "COMPANY"), and Norwest Bank Minnesota, N.A. (the "RIGHTS AGENT").

WHEREAS, effective June 5, 1997 (the "RIGHTS DIVIDEND DECLARATION DATE"), the Board of Directors of the Company (i) authorized and declared a dividend distribution of one Right for each share of common stock, par value \$.001 per share, of the Company (the "COMPANY COMMON STOCK") outstanding at the Close of Business on June 10, 1997 (the "RECORD DATE"), and (ii) authorized the issuance of one Right (as such number may hereinafter be adjusted pursuant hereto) for each share of Company Common Stock issued between the Record Date (whether originally issued or delivered from the Company's treasury) and, except as otherwise provided in Section 22, the Distribution Date, each Right initially representing the right to purchase, upon the terms and subject to the conditions hereinafter set forth, one Unit of Series A Preferred Stock of the Company (the "RIGHTS");

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, the parties hereby agree as follows:

Section 1. CERTAIN DEFINITIONS. For purposes of this Agreement, the following terms have the meanings indicated:

(a) "ACQUIRING PERSON" shall mean any Person who or which, together with all Affiliates or Associates of such Person, shall be the Beneficial Owner of 15% or more of the shares of Company Common Stock then outstanding. Notwithstanding the foregoing: (i) an "Acquiring Person" shall not include (A) the Company, (B) any Subsidiary of the Company, (C) any employee benefit plan maintained by the Company or any of its Subsidiaries, (D) any trustee or fiduciary with respect to such employee benefit plan acting in such capacity or a trustee or fiduciary holding shares of Company Common Stock for the purpose of funding any such plan or employee benefits, (E) any Person who has reported or is required to report Beneficial Ownership of Company Common Stock on Schedule 13G under the Exchange Act (or any comparable or successor report), but only so long as (x) such Person is eligible to report such ownership on Schedule 13(G) under the Exchange Act (or any comparable or successor report), (y) such Person has not reported and is not required to report such ownership on Schedule 13(D) under the Exchange Act (or any comparable or successor report) and such Person does not hold shares of Company Common Stock on behalf of any other Person who is required to report Beneficial Ownership of such shares of Company Common Stock on such Schedule 13(D), and (z) such Person does not beneficially own 20% or more of the shares of Company Common Stock then outstanding, (F) any Person if (1) the Board of Directors of the Company determines in good faith that such Person who would otherwise be an "Acquiring Person" became such inadvertently (including, without limitation, because (x) such Person was unaware that it beneficially owned a percentage of Company Common Stock that would otherwise cause such Person to be an "Acquiring Person" or (y) such Person was aware of the extent of its Beneficial Ownership of

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Company Common Stock but had no actual knowledge of the consequences of such Beneficial Ownership under this Agreement) and without any intention of changing or influencing control of the Company, (2) as promptly as practicable such Person divested or divests itself of Beneficial Ownership of a sufficient number of shares of Company Common Stock so that such Person would no longer beneficially own 15% or more of the then outstanding shares of Company Common Stock, and (3) such Person does not become the Beneficial Owner of any additional shares of Company Common Stock after such Person becomes aware that such Person would be an Acquiring Person (but for the operation of this clause (i)(F)), unless upon becoming the Beneficial Owner of such additional shares such Person is the Beneficial Owner of less than 15% of the then outstanding shares of Company Common Stock, or (G) any Person who becomes the Beneficial Owner of 15% or more of the then outstanding shares of Company Common Stock as a result of the acquisition of shares of Company Common Stock directly from the Company in one or more transactions approved by the Board of Directors, and (ii) no Person shall be deemed an "Acquiring Person" as a result of the acquisition of shares of Company Common Stock by the Company which, by reducing the number of shares of Company Common Stock outstanding, increases the proportional number of shares beneficially owned by such Person; PROVIDED, HOWEVER, that if (A) a Person would become an Acquiring Person (but for the operation of this subclause (ii)) as a result of the acquisition of shares of Company Common Stock by the Company and (B) after such share acquisition by the Company, such Person becomes the Beneficial Owner of any additional shares of Company Common Stock, then such Person shall be deemed an Acquiring Person unless upon becoming the Beneficial Owner of such additional shares such Person is the Beneficial Owner of less than 15% of the then outstanding shares of Company Common Stock. Each Person identified in subclauses (A), (B), (C) and (D) of this Section (1)(a) is individually an "EXEMPT PERSON" and collectively "EXEMPT PERSONS."

(b) "AFFILIATE" and "ASSOCIATE" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended (the "EXCHANGE ACT"), as in effect on the date hereof.

(c) A Person shall be deemed the "BENEFICIAL OWNER" of, and shall be deemed to have "Beneficial Ownership" of, and to "beneficially own", any securities:

(i) of which such Person or any of such Person's Affiliates or Associates is considered to be a "beneficial owner" under Rule 13d-3 of the General Rules and Regulations under the Exchange Act as in effect on the date hereof (the "EXCHANGE ACT REGULATIONS"); PROVIDED, HOWEVER, that a Person shall not be deemed the "Beneficial Owner" of, to have "Beneficial Ownership" of, or to "beneficially own", any securities under this subparagraph (i) as a result of an agreement, arrangement or understanding to vote such securities if such agreement, arrangement or understanding (A) arises solely from a revocable proxy or consent given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the Exchange Act and the Exchange Act Regulations, and (B) is not reportable by such Person

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on Schedule 13D under the Exchange Act (or any comparable or successor report);

(ii) which are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate of such other Person) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing), for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy or consent as described in the proviso to subparagraph (i) of this paragraph (c)) or disposing of such securities; or

(iii) which such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time or upon the satisfaction of conditions) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise;

PROVIDED, HOWEVER, that under this paragraph (c) a Person shall not be deemed the "Beneficial Owner" of, to have "Beneficial Ownership" of, or to "beneficially own", (A) securities tendered pursuant to a tender or exchange offer made in accordance with Exchange Act Regulations by such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for purchase or exchange, (B) securities that may be issued upon exercise of Rights at any time prior to the occurrence of a Triggering Event, or (C) securities that may be issued upon exercise of Rights from and after the occurrence of a Triggering Event, which Rights were acquired by such Person or any of such Person's Affiliates or Associates prior to the Distribution Date or pursuant to Section 3(c) or Section 22 hereof (the "ORIGINAL RIGHTS") or pursuant to Section 11(i) hereof in connection with an adjustment made with respect to any Original Rights; and FURTHER PROVIDED, HOWEVER, that (x) nothing in this paragraph (c) shall cause a Person engaged in business as an underwriter of securities to be the "Beneficial Owner" of, to have "Beneficial Ownership" of, or to "beneficially own," any securities acquired through such Person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition, (y) no decision reached, or action taken, by the Board of Directors of the Company or any committee thereof shall cause any Person (or any Affiliate or Associate of such Person) who is a member of the Board of Directors of the Company or such committee to be deemed, for the purposes of this Agreement, to be a "Beneficial Owner" of, to have "Beneficial Ownership" of, or to "beneficially own" any securities beneficially owned by any other Person (or any Affiliate or Associate of such Person) who is a member of the Board of Directors of the Company or any committee thereof solely by reason of such membership of the Board of Directors or any committee thereof or participation in the decisions or actions thereof on the part of either or both of such Persons and (z) no Person who is an officer, director or employee of an Exempt Person shall be deemed, solely by reason of such Person's status or authority as such, to be the "Beneficial Owner" of, to

have "Beneficial Ownership" of or to "beneficially own" any securities that are "beneficially

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owned" (as defined in this paragraph (c)), including, without limitation, in a fiduciary capacity, by an Exempt Person or by any other such officer, director or employee of an Exempt Person.

(d) "BUSINESS DAY" shall mean any day other than a Saturday, Sunday or a day on which banking institutions in the city of San Francisco, California are authorized or obligated by law or executive order to close.

(e) "CLOSE OF BUSINESS" on any given date shall mean 5:00 P.M., Pacific time, on such date; PROVIDED, HOWEVER, that if such date is not a Business Day it shall mean 5:00 P.M., Mountain time, on the next succeeding Business Day.

(f) "COMMON STOCK" of any Person other than the Company shall mean the capital stock of such Person with the greatest voting power, or, if such Person shall have no capital stock, the equity securities or other equity interest having power to control or direct the management of such Person.

(g) "COMPANY" means DSP Group, Inc., a Delaware corporation, and also means a Principal Party to the extent provided in Section 13(a).

(h) "COMPANY COMMON STOCK" has the meaning set forth in the Whereas Clause.

(i) "DISTRIBUTION DATE" has the meaning set forth in Section 3(a).

(j) "EXPIRATION DATE" has the meaning set forth in Section 7(a).

(k) "PERSON" shall mean any individual, partnership, firm, corporation, association, trust, unincorporated organization or other entity, as well as any syndicate or group deemed to be a person under Section 14(d)(2) of the Exchange Act as in effect on the date hereof.

(l) "PREFERRED STOCK" shall mean the Series A Preferred Stock, par value \$.001 per share, of the Company having the voting powers, designation, preferences and relative, participating, optional or other special rights and qualifications, limitations and restrictions set forth in the Certificate of Designation attached as Exhibit C hereto, as amended from time to time.

(m) "PURCHASE PRICE" has the meaning set forth in Section 7(b).

(n) "RECORD DATE" has the meaning set forth in the Whereas Clause.

(o) "RIGHT" has the meaning set forth in the Whereas Clause.

(p) "RIGHTS CERTIFICATE" has the meaning set forth in Section 3(a).

(q) "RIGHTS DIVIDEND DECLARATION DATE" has the meaning set forth in the Whereas Clause.

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(r) "SECTION 11(a)(ii) EVENT" shall mean the event described in Section 11(a)(ii) hereof.

(s) "SECTION 13 EVENT" shall mean any event described in clause (x), (y) or (z) of Section 13(a) hereof.

(t) "STOCK ACQUISITION DATE" shall mean the first date of public announcement (including, without limitation, the filing of any report, or any amendment to any report, pursuant to Section 13(d) of the Exchange Act

(or any comparable or successor report)) by the Company or an Acquiring Person that an Acquiring Person has become such.

(u) "SUBSIDIARY" shall mean, with reference to any Person, any other Person of which an amount of voting securities or equity interests sufficient to elect at least a majority of the directors or equivalent governing body of such other Person is beneficially owned, directly or indirectly, by such Person, or otherwise controlled by such first-mentioned Person.

(v) "SUMMARY OF RIGHTS" has the meaning set forth in Section 3(b).

(w) "TRIGGERING EVENT" shall mean any Section 11(a)(ii) Event or any Section 13 Event.

(x) "UNIT" has the meaning set forth in Section 7(b).

In addition, the following terms are defined in the Sections indicated below:

| Defined Term ----- | Section Number ----- |
|----------------------------|-------------------------|
| Adjustment Shares | 11(a)(ii) |
| common stock equivalents | 11(a)(iii) |
| Current Value | 11(a)(iii) |
| Depositary Agent | 7(c) |
| Equivalent Preferred Stock | 11(b) |

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| | |
|---------------------------------|------------|
| Exchange Act | 1(b) |
| Exchange Act Regulations | 1(c) |
| Exchange Ratio | 34(a) |
| Exempt Person | 1(a) |
| Final Expiration Date | 7(a) |
| Nasdaq | 11(d)(i) |
| Original Rights | 1(c) |
| Redemption Price | 23(a) |
| Registered Common Stock | 13(b)(ii) |
| Registration Date | 9(c) |
| Registration Statement | 9(c) |
| Section 11(a)(iii) Trigger Date | 11(a)(iii) |
| Securities Act | 9(c) |
| Spread | 11(a)(iii) |
| Substitution Period | 11(a)(iii) |
| Trading Day | 11(d)(i) |

Section 2. APPOINTMENT OF RIGHTS AGENT. The Company hereby appoints the Rights Agent to act as agent for the Company in accordance with the terms and conditions hereof, and the Rights Agent hereby accepts such appointment. With the consent of the Rights Agent, the Company may from time to time appoint such co-rights agents as it may deem necessary or desirable.

Section 3. ISSUE OF RIGHTS CERTIFICATES. (a) Until the earlier of (i) the Close of Business on the tenth Business Day after the Stock Acquisition Date, and (ii) the Close of Business on the tenth Business Day (or such later date as may be determined by action of a majority of the Board of Directors of the Company prior to the occurrence of a Section 11(a)(ii) Event) after the date that a tender or exchange offer by any Person (other than an Exempt Person) is first published or sent or given within the meaning of Rule 14d-4(a) of the Exchange Act Regulations or any successor rule, if upon consummation thereof such Person would be an Acquiring Person (including, in the case of both clauses

(i) and (ii), any such time which is after the date of this Agreement and prior to the issuance of the Rights)(the earlier of (i) and (ii) above being the "DISTRIBUTION DATE"), (x) the Rights will be evidenced (subject to the provisions of paragraph (b) of this Section 3) by the certificates for shares of Company Common Stock registered in the names of the holders of shares of Company Common Stock as of and subsequent to the Record Date (which certificates for shares of Company Common Stock shall be deemed also to be certificates for Rights) and not by separate certificates, and (y) the Rights will be transferable only in connection with the transfer of the underlying shares of Company Common Stock including a transfer to the Company; PROVIDED, HOWEVER, that if a tender or exchange offer is terminated prior to the occurrence of a Distribution Date, then no Distribution Date shall occur as a result of such tender or exchange offer. As soon as practicable after the Distribution Date, the Rights Agent will send by first-class, insured, postage prepaid mail, to each record holder of shares of Company Common Stock as of the Close of Business on the Distribution Date, at the address of such holder shown on the records of the Company, one or more rights certificates, in substantially the form of Exhibit A hereto (the "RIGHTS CERTIFICATES"), evidencing one Right for each share of Company Common Stock so held, subject to adjustment as provided herein.

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In the event that an adjustment in the number of Rights per share of Company Common Stock has been made pursuant to Section 11(p) hereof, at the time of distribution of the Rights Certificates, the Company may make the necessary and appropriate rounding adjustments (in accordance with Section 14(a) hereof) so that Rights Certificates representing only whole numbers of Rights are distributed and cash is paid in lieu of any fractional Rights. As of and after the Distribution Date, the Rights will be evidenced solely by such Rights Certificates.

(b) As promptly as practicable following the Record Date, the Company will send a copy of a Summary of Rights to Purchase Preferred Stock, in substantially the form attached hereto as Exhibit B (the "SUMMARY OF RIGHTS"), by first-class, postage prepaid mail, to each record holder of shares of Company Common Stock as of the Close of Business on the Record Date, at the address of such holder shown on the records of the Company. With respect to certificates for Company Common Stock outstanding as of the Record Date, until the Distribution Date, the Rights will be evidenced by such certificates registered in the names of the holders thereof together with the Summary of Rights. Until the Distribution Date (or, if earlier, the Expiration Date), the surrender for transfer of any such certificate for Company Common Stock outstanding as of the Record Date, with or without a copy of the Summary of Rights, shall also constitute the transfer of the Rights associated with the Company Common Stock represented thereby.

(c) Rights shall, without any further action, be issued in respect of all shares of Company Common Stock which are issued (including any shares of Company Common Stock held in treasury) after the Record Date but prior to the earlier of the Distribution Date and the Expiration Date. Certificates, representing such shares of Company Common Stock, issued after the Record Date shall bear the following legend:

This certificate also evidences and entitles the holder hereof to certain Rights as set forth in the Rights Agreement between DSP Group, Inc. (the "Company") and Norwest Bank Minnesota, N.A. (the "Rights Agent") dated as of June 5, 1997, as amended from time to time (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal office of the stock transfer administration office of the Rights Agent. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. The Company will mail to the holder of this certificate a copy of the Rights Agreement, as in effect on the date of mailing, without charge promptly after receipt of a written request therefor. UNDER CERTAIN CIRCUMSTANCES SET FORTH IN THE RIGHTS AGREEMENT, RIGHTS ISSUED TO, OR HELD BY, ANY PERSON WHO IS, WAS OR BECOMES AN ACQUIRING PERSON OR ANY AFFILIATE OR ASSOCIATE THEREOF (AS SUCH TERMS ARE DEFINED IN THE RIGHTS AGREEMENT), WHETHER CURRENTLY HELD BY OR ON BEHALF OF SUCH PERSON OR BY ANY SUBSEQUENT HOLDER, MAY BECOME NULL AND VOID.

With respect to certificates representing shares of Company Common Stock that bear the foregoing legend, until the earlier of the Distribution Date and the

Expiration Date, the Rights associated with the shares of Company Common Stock represented by such certificates shall be

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evidenced by such certificates alone and registered holders of the shares of Company Common Stock shall also be the registered holders of the associated Rights, and the transfer of any of such certificates shall also constitute the transfer of the Rights associated with the shares of Company Common Stock represented by such certificates.

Section 4. FORM OF RIGHTS CERTIFICATES. The Rights Certificates (and the forms of election to purchase, assignment and certificate to be printed on the reverse thereof) shall each be substantially in the form set forth in Exhibit A hereto and may have such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Company may deem appropriate and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any applicable law or any rule or regulation thereunder or with any rule or regulation of any stock exchange or automated quotation system on which the Rights may from time to time be listed or to conform to usage. Subject to the provisions of Section 11 and Section 22 hereof, the Rights Certificates, whenever distributed, shall be dated as of the Record Date and on their face shall entitle the holders thereof to purchase such number of Units of Preferred Stock as shall be set forth therein at the price set forth therein, but the amount and type of securities, cash or other assets that may be acquired upon the exercise of each Right and the Purchase Price thereof shall be subject to adjustment as provided herein.

Section 5. COUNTERSIGNATURE AND REGISTRATION . (a) Rights Certificates shall be executed on behalf of the Company by its Chairman, the President or one of its Vice Presidents under its corporate seal reproduced thereon attested by its Secretary, Treasurer or one of its Assistant Secretaries. The signature of any of these officers on the Rights Certificates may be manual or facsimile. Rights Certificates bearing the manual or facsimile signatures of the individuals who were at any time the proper officers of the Company shall bind the Company, notwithstanding that such individuals or any of them have ceased to hold such offices prior to the countersignature of such Rights Certificates or did not hold such offices at the date of such Rights Certificates. No Rights Certificate shall be entitled to any benefit under this Agreement or be valid for any purpose unless there appears on such Rights Certificate a countersignature duly executed by the Rights Agent by manual signature of an authorized signatory, and such countersignature upon any Rights Certificate shall be conclusive evidence, and the only evidence, that such Rights Certificate has been duly countersigned as required hereunder.

(b) Following the Distribution Date, the Rights Agent will keep or cause to be kept, at its office designated for surrender of Rights Certificates upon exercise or transfer, books for registration and transfer of the Rights Certificates issued hereunder. Such books shall show the name and address of each holder of the Rights Certificates, the number of Rights evidenced on its face by each Rights Certificate and the date of each Rights Certificate.

Section 6. TRANSFER, SPLIT UP, COMBINATION AND EXCHANGE OF RIGHTS CERTIFICATES; MUTILATED, DESTROYED, LOST OR STOLEN RIGHTS CERTIFICATES. (a) Subject to the provisions of Sections 4, 7(e) and 14 hereof, at any time after the Close of Business on the Distribution Date, and at or prior to the Close of Business on the Expiration Date, any Rights Certificate or Certificates may be transferred, split up, combined or exchanged for another Rights Certificate or Certificates, entitling the registered holder to purchase a like number of Units of Preferred Stock (or, following a Triggering Event, other securities, cash or other assets, as the case may be) as the

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Rights Certificate or Certificates surrendered then entitled such holder to purchase. Any registered holder desiring to transfer, split up, combine or exchange any Rights Certificate or Certificates shall make such request in writing delivered to the Rights Agent, and shall surrender the Rights Certificate or Certificates to be transferred, split up, combined or exchanged at the office of the Rights Agent designated for such purpose. Neither the Rights Agent nor the Company shall be obligated to take any action whatsoever

with respect to the transfer of any such surrendered Rights Certificate until the registered holder shall have completed and executed the certificate set forth in the form of assignment on the reverse side of such Rights Certificate and shall have provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) of the Rights represented by such Rights Certificate or Affiliates or Associates thereof as the Company shall reasonably request; whereupon the Rights Agent shall, subject to the provisions of Section 7(e) and Section 14 hereof, countersign and deliver to the Person entitled thereto a Rights Certificate or Rights Certificates, as the case may be, as so requested. The Company may require payment of a sum sufficient to cover any tax or governmental charge that may be imposed in connection with any transfer, split up, combination or exchange of Rights Certificates.

(b) Subject to Section 7(e) hereof, if a Rights Certificate shall be mutilated, lost, stolen or destroyed, upon request by the registered holder of the Rights represented thereby and upon payment to the Company and the Rights Agent of all reasonable expenses incident thereto, there shall be issued, in exchange for and upon cancellation of the mutilated Rights Certificate, or in substitution for the lost, stolen or destroyed Rights Certificate, a new Rights Certificate, in substantially the form of the prior Rights Certificate, of like tenor and representing the equivalent number of Rights, but, in the case of loss, theft or destruction, only upon receipt of evidence satisfactory to the Company and the Rights Agent of such loss, theft or destruction of such Rights Certificate and, if requested by the Company or the Rights Agent, indemnity also satisfactory to it.

Section 7. EXERCISE OF RIGHTS; PURCHASE PRICE; EXPIRATION DATE OF RIGHTS.

(a) Prior to the earlier of (i) the Close of Business on the tenth anniversary hereof (the "FINAL EXPIRATION DATE"), (ii) the time at which the Rights are redeemed as provided in Section 23 hereof and (iii) the time at which the Rights are exchanged as provided in Section 34 hereof (the earlier of (i), (ii) and (iii) being the "EXPIRATION DATE"), the registered holder of any Rights Certificate may, subject to the provisions of Sections 7(e), 9(c) and 11(a)(ii) hereof, exercise the Rights evidenced thereby, in whole or in part, at any time after the Distribution Date upon surrender of the Rights Certificate, with the form of election to purchase and the certificate on the reverse side thereof duly executed, to the Rights Agent at the office of the Rights Agent designated for such purpose, together with payment of the aggregate Purchase Price (as hereinafter defined) for the number of Units of Preferred Stock (or, following a Triggering Event, other securities, cash or other assets, as the case may be) for which such surrendered Rights are then exercisable.

(b) The purchase price for each one one-thousandth of a share (each such one one-thousandth of a share being a "UNIT") of Preferred Stock upon exercise of Rights shall be \$70.00, subject to adjustment from time to time as provided in Sections 11 and 13(a) hereof (such purchase price, as so adjusted, being the "PURCHASE PRICE"), and shall be payable in accordance with paragraph (c) below.

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(c) As promptly as practicable following the occurrence of the Distribution Date, the Company shall deposit with the Rights Agent or other corporation in good standing organized under the laws of the United States or any State of the United States, which is authorized under such laws to exercise corporate trust or stock transfer powers and is subject to supervision or examination by federal or state authority (such institution being the "DEPOSITARY AGENT"), certificates representing the shares of Preferred Stock that may be acquired upon exercise of the Rights and shall cause such Depositary Agent to enter into an agreement pursuant to which the Depositary Agent shall issue receipts representing interests in the shares of Preferred Stock so deposited. Upon receipt of a Rights Certificate representing exercisable Rights, with the form of election to purchase and the certificate duly executed, accompanied by payment, with respect to each Right so exercised, of the Purchase Price for the Units of Preferred Stock (or, following a Triggering Event, other securities, cash or other assets, as the case may be) to be purchased thereby as set forth below and an amount equal to any applicable transfer tax or evidence satisfactory to the Company of payment of such tax, the Rights Agent shall, subject to Section 20(k) hereof, thereupon promptly (i) requisition from the Depositary Agent depositary receipts representing such number of Units of Preferred Stock as are to be purchased and the Company will direct the Depositary Agent to comply with such request, (ii) requisition from the Company the amount of cash, if any, to be paid in lieu of fractional shares in

accordance with Section 14 hereof, (iii) after receipt of such depositary receipts, cause the same to be delivered to or upon the order of the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, and (iv) after receipt thereof, deliver such cash, if any, to or upon the order of the registered holder of such Rights Certificate. In the event that the Company is obligated to issue Company Common Stock, other securities of the Company, pay cash and/or distribute other property pursuant to Section 11(a) hereof, the Company will make all arrangements necessary so that such Company Common Stock, other securities, cash and/or other property are available for distribution by the Rights Agent, if and when appropriate. The payment of the Purchase Price (as such amount may be reduced pursuant to Section 11(a)(iii) hereof) may be made in cash or by certified or bank check or money order payable to the order of the Company.

(d) In case the registered holder of any Rights Certificate shall exercise less than all the Rights evidenced thereby, a new Rights Certificate evidencing the Rights remaining unexercised shall be issued by the Rights Agent and delivered to, or upon the order of, the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, subject to the provisions of Section 14 hereof.

(e) Notwithstanding anything in this Agreement to the contrary, from and after the first occurrence of a Section 11(a)(ii) Event, any Rights beneficially owned by (i) an Acquiring Person or an Associate or Affiliate of an Acquiring Person, (ii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) which becomes a transferee after the Acquiring Person becomes such, or (iii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) which becomes a transferee prior to or concurrently with the Acquiring Person becoming such and which receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person (or any such Associate or Affiliate) to holders of equity interests in such Acquiring Person (or any such Associate or Affiliate) or to any Person with whom the Acquiring Person (or such Associate or Affiliate) has any continuing agreement,

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arrangement or understanding regarding the transferred Rights, shares of Company Common Stock or the Company or (B) a transfer which the Board of Directors has determined to be part of a plan, arrangement or understanding which has as a primary purpose or effect the avoidance of this Section 7(e), shall be null and void without any further action, and no holder of such Rights shall have any rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise. The Company shall use all reasonable efforts to ensure that the provisions of this Section 7(e) are complied with, but shall have no liability to any holder of Rights or any other Person as a result of its failure to make any determination under this Section 7(e) with respect to an Acquiring Person or its Affiliates, Associates or transferees.

(f) Notwithstanding anything in this Agreement or any Rights Certificate to the contrary, neither the Rights Agent nor the Company shall be obligated to undertake any action with respect to a registered holder upon the occurrence of any purported exercise by such registered holder unless such registered holder shall have (i) completed and executed the certificate following the form of election to purchase set forth on the reverse side of the Rights Certificate surrendered for such exercise, and (ii) provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) of the Rights represented by such Rights Certificate or Affiliates or Associates thereof as the Company shall reasonably request.

Section 8. CANCELLATION AND DESTRUCTION OF RIGHTS CERTIFICATES. All Rights Certificates surrendered for the purpose of exercise, transfer, split up, combination or exchange shall, if surrendered to the Company or any of its agents, be delivered to the Rights Agent for cancellation or in canceled form, or, if surrendered to the Rights Agent, shall be canceled by it, and no Rights Certificates shall be issued in lieu thereof except as expressly permitted by this Agreement. The Company shall deliver to the Rights Agent for cancellation and retirement, and the Rights Agent shall so cancel and retire, any Rights Certificates acquired by the Company otherwise than upon the exercise thereof. The Rights Agent shall deliver all canceled Rights Certificates to the Company.

Section 9. RESERVATION AND AVAILABILITY OF CAPITAL STOCK. (a) The Company shall at all times prior to the Expiration Date cause to be reserved and kept

available, out of its authorized and unissued shares of preferred stock, the number of shares of Preferred Stock that, as provided in this Agreement, will be sufficient to permit the exercise in full of all outstanding Rights. Upon the occurrence of any events resulting in an increase in the aggregate number of shares of Preferred Stock (or other equity securities of the Company) issuable upon exercise of all outstanding Rights above the number then reserved, the Company shall make appropriate increases in the number of shares so reserved to the extent practicable.

(b) If the shares of Preferred Stock to be issued and delivered upon the exercise of the Rights may be listed on any national securities exchange or automated quotation system, the Company shall during the period from the Distribution Date through the Expiration Date use its best efforts to cause all securities reserved for such issuance to be listed on such exchange or system upon official notice of issuance upon such exercise.

(c) The Company shall use its best efforts (i) as soon as practicable following the occurrence of a Section 11(a)(ii) Event and a determination by the Company in accordance with

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Section 11(a)(iii) hereof of the consideration to be delivered by the Company upon exercise of the Rights or, if so required by law, as soon as practicable following the Distribution Date (such date being the "REGISTRATION DATE"), to file a registration statement on an appropriate form under the Securities Act of 1933, as amended (the "SECURITIES ACT"), with respect to the securities that may be acquired upon exercise of the Rights (the "REGISTRATION STATEMENT"), (ii) to cause the Registration Statement to become effective as soon as practicable after such filing, (iii) to cause the Registration Statement to continue to be effective (and to include a prospectus complying with the requirements of the Securities Act) until the earlier of (A) the date as of which the Rights are no longer exercisable for the securities covered by the Registration Statement, and (B) the Expiration Date and (iv) to take as soon as practicable following the Registration Date such action as may be required to ensure that any acquisition of securities upon exercise of the Rights complies with any applicable state securities or "blue sky" laws. The Company may temporarily suspend, for a period of time not to exceed one hundred twenty (120) days after the date set forth in clause (i) of the first sentence of this Section 9(c), the exercisability of the Rights in order to prepare and file such registration statement and permit it to become effective. Upon any such suspension, the Company shall issue a public announcement stating that the exercisability of the Rights has been temporarily suspended, as well as a public announcement at such time as the suspension is no longer in effect. In addition, if the Company shall determine that a registration statement is required following the Distribution Date, the Company may temporarily suspend the exercisability of the Rights until such time as a registration statement has been declared effective. Notwithstanding any provision of this Agreement to the contrary, the Rights shall not be exercisable in any jurisdiction if the requisite qualification in such jurisdiction shall not have been obtained, the exercise thereof shall not be permitted under applicable law or a registration statement shall not have been declared effective.

(d) The Company shall take such action as may be necessary to ensure that all shares of Preferred Stock (and, following the occurrence of a Triggering Event, any other securities that may be delivered upon exercise of Rights) shall be, at the time of delivery of the certificates or depository receipts for such securities (subject to payment of the Purchase Price), duly and validly authorized and issued and fully paid and non-assessable.

(e) The Company shall pay any documentary, stamp or transfer tax imposed in connection with the issuance or delivery of the Rights Certificates or upon the exercise of Rights; PROVIDED, HOWEVER, the Company shall not be required to pay any such tax imposed in connection with the issuance or delivery of Units of Preferred Stock, or any certificates or depository receipts for such Units of Preferred Stock (or, following the occurrence of a Triggering Event, any other securities, cash or assets, as the case may be) to any Person other than the registered holder of the Rights Certificates evidencing the Rights surrendered for exercise. The Company shall not be required to issue or deliver any certificates or depository receipts for Units of Preferred Stock (or, following the occurrence of a Triggering Event, any other securities, cash or assets, as the case may be) to, or in a name other than that of, the registered holder upon the exercise of any Rights until any such tax shall have been paid

(any such tax being payable by the holder of such Rights Certificate at the time of surrender) or until it has been established to the Company's satisfaction that no such tax is due.

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Section 10. PREFERRED STOCK RECORD DATE. Each Person in whose name any certificate or depositary receipt for Units of Preferred Stock (or, following the occurrence of a Triggering Event, other securities) is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of the Units of Preferred Stock (or, following the occurrence of a Triggering Event, other securities) represented thereby on, and such certificate shall be dated, the date upon which the Rights Certificate evidencing such Rights was duly surrendered and payment of the Purchase Price (and any applicable transfer taxes) was made; PROVIDED, HOWEVER, that if the date of such surrender and payment is a date upon which the Preferred Stock (or, following the occurrence of a Triggering Event, other securities) transfer books of the Company are closed, such Person shall be deemed to have become the record holder of such securities on, and such certificate shall be dated, the next succeeding Business Day on which the Preferred Stock (or, following the occurrence of a Triggering Event, other securities) transfer books of the Company are open and, FURTHER PROVIDED, HOWEVER, that if delivery of Units of Preferred Stock (or, following the occurrence of a Triggering Event, other securities) is delayed pursuant to Section 9(c) or 11(a)(ii) hereof, such Persons shall be deemed to have become the record holders of such Units of Preferred Stock (or, following the occurrence of a Triggering Event, other securities) only when such Units (or other securities) first become deliverable. Prior to the exercise of the Rights evidenced thereby, the holder of a Rights Certificate shall not be entitled to any rights of a stockholder of the Company with respect to securities for which the Rights shall be exercisable, including, without limitation, the right to vote, to receive dividends or other distributions or to exercise any preemptive rights, and shall not be entitled to receive any notice of any proceedings of the Company, except as provided herein.

Section 11. ADJUSTMENT OF PURCHASE PRICE, NUMBER AND KIND OF SHARES OR NUMBER OF RIGHTS. The Purchase Price, the number and kind of securities purchasable upon exercise of each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 11.

(a)(i) In the event the Company shall at any time after the date of this Agreement (A) declare a dividend on the Preferred Stock payable in shares of Preferred Stock, (B) subdivide the outstanding Preferred Stock, (C) combine the outstanding Preferred Stock into a smaller number of shares, or (D) issue any shares of its capital stock in a reclassification of the Preferred Stock (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing or surviving corporation), except as otherwise provided in this Section 11(a), the Purchase Price in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination or reclassification, and the number and kind of shares of Preferred Stock or capital stock, as the case may be, issuable on such date upon exercise of the Rights, shall be proportionately adjusted so that the holder of any Right exercised after such time shall be entitled to receive, upon payment of the Purchase Price then in effect, the aggregate number and kind of shares of Preferred Stock or capital stock, as the case may be, which, if such Right had been exercised immediately prior to such date, such holder would have owned upon such exercise and been entitled to receive by virtue of such dividend, subdivision, combination or reclassification; PROVIDED, HOWEVER, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Company issuable upon the

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exercise of one Right. If an event occurs which would require an adjustment under both this Section 11(a)(i) and Section 11(a)(ii) hereof, the adjustment provided for in this Section 11(a)(i) shall be in addition to, and shall be made prior to, any adjustment required pursuant to Section 11(a)(ii) hereof.

(ii) Subject to Section 34 hereof, in the event any Person shall

become an Acquiring Person (the first occurrence of such event being a "SECTION 11(a)(ii) EVENT"), then (A) the Purchase Price shall be adjusted to be the Purchase Price in effect immediately prior to the Section 11(a)(ii) Event multiplied by the number of Units of Preferred Stock for which a Right was exercisable immediately prior to such Section 11(a)(ii) Event, whether or not such Right was then exercisable, and (B) each holder of a Right, except as otherwise provided in this Section 11(a)(ii) and Section 7(e) and Section 11(a)(iii) hereof, shall thereafter have the right to receive, upon exercise thereof at a price equal to the Purchase Price (as so adjusted), in accordance with the terms of this Agreement, such number of Units of Preferred Stock as shall equal the result obtained by dividing the Purchase Price (as so adjusted) by 50% of the current per share market price of the Preferred Stock (determined pursuant to Section 11(d) hereof) on the date of such Section 11(a)(ii) Event (such Units of Preferred Stock being the "ADJUSTMENT SHARES"); PROVIDED, HOWEVER, that the Purchase Price (as so adjusted) and the number of Units of Preferred Stock so receivable upon exercise of a Right shall, following the Section 11(a)(ii) Event, be subject to further adjustment as appropriate in accordance with Section 11 hereof. Notwithstanding the foregoing, the Rights shall not be exercisable pursuant to this Section 11(a)(ii) until the time period during which the Rights may be redeemed pursuant to Section 23 hereof shall have expired.

(iii) The Company, by the vote of a majority of the Board of Directors, may at its option substitute for a Unit of Preferred Stock issuable upon the exercise of Rights in accordance with the foregoing subparagraph (ii), shares of Company Common Stock or fractions thereof having a current market price (as determined by Section 11(d) hereof) equal to the current market price of a Unit of Preferred Stock on the date of the Section 11(a)(ii) Event. In the event that the number of shares of Preferred Stock which are authorized by the Company's Restated Certificate of Incorporation but not outstanding or reserved for issuance for purposes other than upon exercise of the Rights is not sufficient to permit the exercise in full of the Rights in accordance with the foregoing subparagraph (ii) of this Section 11(a), the Company, by the vote of a majority of the Board of Directors, shall, to the extent permitted by applicable law and any material agreements then in effect to which the Company is a party: (A) determine the excess (such excess being the "SPREAD") of (1) the aggregate value of the Adjustment Shares issuable upon the exercise of a Right (the "CURRENT VALUE") over (2) the Purchase Price (as adjusted in accordance with the foregoing subparagraph (ii)), and (B) with respect to each Right (other than Rights which have become void pursuant to Section 7(e)), make adequate provision to substitute, in whole or in part, for such Adjustment Shares, upon exercise of a Right and payment of the Purchase Price (as adjusted in accordance with the foregoing subparagraph (ii)), (1) cash, (2) a reduction in the Purchase Price, (3) shares of Company Common Stock or other equity securities of the Company (including, without limitation, shares, or units of shares, of preferred stock (such other shares being "COMMON STOCK

EQUIVALENTS")), (4) debt securities of the Company, (5) other assets, or (6) any combination of the foregoing, having an aggregate value which, when added to the value of the Units of Preferred Stock actually issued upon exercise of such Right, shall have an aggregate value equal to the Current Value (less the amount of any reduction in such Purchase Price), where such aggregate value has been determined by a majority of the Board of Directors, after receiving advice from a nationally recognized investment banking firm; PROVIDED, HOWEVER, that if the Company shall not have made adequate provision to deliver value pursuant to clause (B) above within thirty (30) days following the later of (x) the first occurrence of a Section 11(a)(ii) Event and (y) the date on which the Company's right of redemption pursuant to Section 23(a) expires (the later of (x) and (y) being referred to herein as the "SECTION 11(a)(iii) TRIGGER DATE"), then, subject to Section 34 hereof, the Company shall be obligated (to the extent permitted by applicable law and any material agreements then in effect to which the Company is a party) to deliver, upon the surrender for exercise of a Right and without requiring payment of the Purchase Price, Units of Preferred Stock (to the extent available) and/or shares (or fractions of shares, at the discretion of the Board) of Company Common Stock (to the extent available), and then, if necessary, cash or a combination thereof, which Units of Preferred Stock, shares (or fractions of shares) of Company

Common Stock and/or cash shall have an aggregate value equal to the Spread. If, upon the occurrence of the Section 11(a) (ii) Event, a majority of the Board of Directors elects to issue shares of Company Common Stock upon exercise of the Rights and determines in good faith that it is likely that sufficient additional shares of Company Common Stock could be authorized for issuance upon exercise in full of the Rights, then, if a majority of the Board of Directors so elects, the thirty (30) day period set forth above may be extended to the extent necessary, but not more than ninety (90) days after the Section II(a)(iii) Trigger Date, in order that the Company may seek stockholder approval for the authorization of such additional shares (such thirty (30) day period, as it may be extended, is herein called the "SUBSTITUTION PERIOD"). To the extent that the Company determines that some action need be taken pursuant to the second and/or third sentence of this Section 11(a)(iii), the Company (x) shall provide, subject to Section 7(e) hereof and the last sentence of this subparagraph (iii), that such action shall apply uniformly to all outstanding Rights and (y) may suspend the exercisability of the Rights until the expiration of the Substitution Period in order to seek any authorization of additional shares and/or to decide the appropriate form of distribution to be made pursuant to such second sentence and to determine the value thereof. For purposes of this Section 11(a)(iii), the value of a Unit of Preferred Stock or share of Company Common Stock shall be the current market price (as determined pursuant to Section 11(d) hereof) per Unit of Preferred Stock or share of Company Common Stock, as the case may be, on the Section 11(a)(iii) Trigger Date and the value of any common stock equivalent shall be deemed to have the same value as a share of Company Common Stock on such date. A majority of the Board of Directors of the Company may, but shall not be required to, establish procedures to allocate the right to receive Units of Preferred Stock or shares of Company Common Stock, as the case may be, upon the exercise of the Rights among holders of Rights pursuant to this Section 11(a)(iii).

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(b) In case the Company shall fix a record date for the issuance of rights, options or warrants to all holders of Preferred Stock entitling them to subscribe for or purchase (for a period expiring within forty-five calendar days after such record date) shares of Preferred Stock (or shares having substantially the same rights, privileges and preferences as shares of Preferred Stock ("EQUIVALENT PREFERRED STOCK")) or securities convertible into Preferred Stock or Equivalent Preferred Stock at a price per share of Preferred Stock or per share of Equivalent Preferred Stock (or having a conversion price per share, if a security convertible into Preferred Stock or Equivalent Preferred Stock) less than the current market price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock on such record date, the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the sum of the number of shares of Preferred Stock outstanding on such record date plus the number of shares of Preferred Stock which the aggregate offering price of the total number of shares of Preferred Stock and/or Equivalent Preferred Stock so to be offered (and/or the aggregate initial conversion price of the convertible securities so to be offered) would purchase at such current market price, and the denominator of which shall be the number of shares of Preferred Stock outstanding on such record date plus the number of additional shares of Preferred Stock and/or Equivalent Preferred Stock to be offered for subscription or purchase (or into which the convertible securities so to be offered are initially convertible) PROVIDED, HOWEVER, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Company issuable upon exercise of one Right. In case such subscription price may be paid by delivery of consideration part or all of which may be in a form other than cash, the value of such consideration shall be as determined in good faith by a majority of the Board of Directors, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holders of the Rights. Shares of Preferred Stock owned by or held for the account of the Company shall not be deemed outstanding for the purpose of any such computation. Such adjustment shall be made successively whenever such a record date is fixed, and in the event that such rights, options or warrants are not so issued, the Purchase Price shall be adjusted to be the Purchase Price which would then be in effect if such record date had not been fixed.

(c) In case the Company shall fix a record date for a distribution to all holders of shares of Preferred Stock (including any such distribution made in connection with a consolidation or merger in which the Company is the continuing or surviving corporation) of evidences of indebtedness, cash (other than a regular quarterly cash dividend paid out of funds legally available therefor), assets (other than a dividend payable in shares of Preferred Stock, but including any dividend payable in stock other than Preferred Stock) or subscription rights, options or warrants (excluding those referred to in Section 11(b) hereof), the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the current market price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock on such record

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date less the fair market value (as determined in good faith by a majority of the Board of Directors, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holder of the Rights) of the cash, assets or evidences of indebtedness so to be distributed or of such subscription rights, options or warrants distributable in respect of a share of Preferred Stock and the denominator of which shall be such current market price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock PROVIDED, HOWEVER, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Company to be issued upon exercise of one Right. Such adjustments shall be made successively whenever such a record date is fixed, and in the event that such distribution is not so made, the Purchase Price shall be adjusted to be the Purchase Price which would have been in effect if such record date had not been fixed.

(d) (i) For the purpose of any computation hereunder, the "current market price" per share of Company Common Stock or Common Stock on any date shall be deemed to be the average of the daily closing prices per share of such shares for the ten consecutive Trading Days (as such term is hereinafter defined) immediately prior to such date; PROVIDED, HOWEVER, if prior to the expiration of such requisite ten Trading Day period the issuer announces either (A) a dividend or distribution on such shares payable in such shares or securities convertible into such shares (other than the Rights), or (B) any subdivision, combination or reclassification of such shares, then, following the ex-dividend date for such dividend or the record date for such subdivision, combination or reclassification, as the case may be, the "current market price" shall be properly adjusted to take into account such event. The closing price for each day shall be, if the shares are listed and admitted to trading on a national securities exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which such shares are listed or admitted to trading or, if such shares are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by the Nasdaq Stock Market ("NASDAQ") or such other system then in use, or, if on any such date such shares are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in such shares selected by a majority of the Board of Directors. If on any such date no market maker is making a market in such shares, the fair value of such shares on such date as determined in good faith by a majority of the Board of Directors shall be used. If such shares are not publicly held or not so listed or traded, "current market price" per share shall mean the fair value per share as determined in good faith by a majority of the Board of Directors, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes. The term "TRADING DAY" shall mean, if such shares are listed or admitted to trading on any national securities exchange, a day on which the principal national securities exchange on which such shares are listed or admitted to trading is open for the transaction of business or, if such shares are not so listed or admitted, a Business Day.

(ii) For the purpose of any computation hereunder, the "current market price" per share of Preferred Stock shall be determined in the same manner as set forth above for Company Common Stock in subparagraph (i) of this Section 11(d) (other than the fourth sentence thereof). If the current market price per share of Preferred Stock cannot be determined in the manner provided above or if the Preferred Stock is not publicly held or listed or traded in a manner described in subparagraph (i) of this Section 11(d), the "current market price" per share of Preferred Stock shall be conclusively deemed to be an amount equal to 1,000 (as such amount may be appropriately adjusted for such events as stock splits, stock dividends and recapitalizations with respect to Company Common Stock occurring after the date of this Agreement) multiplied by the current market price per share of Company Common Stock. If neither Company Common Stock nor Preferred Stock is publicly held or so listed or traded, "current market price" per share of the Preferred Stock shall mean the fair value per share as determined in good faith by a majority of the Board of Directors whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holders of the Rights. For all purposes of this Agreement, the "current market price" of a Unit of Preferred Stock shall be equal to the "current market price" of one share of Preferred Stock divided by 1,000.

(e) Anything herein to the contrary notwithstanding, no adjustment in the Purchase Price shall be required unless such adjustment would require an increase or decrease of at least 1% in the Purchase Price; PROVIDED, HOWEVER, that any adjustments which by reason of this Section 11(e) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 11 shall be made to the nearest cent or to the nearest one hundred-thousandth of a share of Preferred Stock, Company Common Stock or Common Stock or other share or security, as the case may be. Notwithstanding the first sentence of this Section 11(e), any adjustment required by this Section 11 shall be made no later than the earlier of (i) three years from the date of the transaction which mandates such adjustment and (ii) the Expiration Date.

(f) If as a result of an adjustment made pursuant to Section 11(a) or 13(a) hereof, the holder of any Right thereafter exercised shall become entitled to receive any shares of capital stock other than Preferred Stock, thereafter the number of such other shares so receivable upon exercise of any Right and the Purchase Price thereof shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Preferred Stock contained in Sections 11(a), (b), (c), (e), (g), (h), (i), (k), (l) and (m), and the provisions of Sections 7, 9, 10, 13 and 14 hereof with respect to the Preferred Stock shall apply on like terms to any such other shares.

(g) All Rights originally issued by the Company subsequent to any adjustment made to the Purchase Price hereunder shall evidence the right to purchase, at the adjusted Purchase Price, the number of Units of Preferred Stock (or other securities or amount of cash or combination thereof) that may be acquired from time to time hereunder upon exercise of the Rights, all subject to further adjustment as provided herein.

(h) Unless the Company shall have exercised its election as provided in Section 11(i), upon each adjustment of the Purchase Price as a result of the calculations made in Sections 11(b) and (c), each Right outstanding immediately prior to the making of such adjustment shall thereafter evidence the right to purchase, at the adjusted Purchase Price, that number of Units of Preferred Stock (calculated to the nearest one hundred-thousandth of a Unit) obtained by (i) multiplying (x) the number of Units of Preferred Stock covered by a Right immediately prior to such adjustment by (y) the Purchase Price in effect immediately prior to such adjustment of the Purchase Price and (ii) dividing the product so obtained by the Purchase Price in effect immediately after such adjustment of the Purchase Price.

(i) The Company may elect on or after the date of any adjustment of the Purchase Price to adjust the number of Rights, in lieu of any

adjustment in the number of Units of Preferred Stock that may be acquired upon the exercise of a Right. Each of the Rights outstanding after the adjustment in the number of Rights shall be exercisable for the number of Units of Preferred Stock for which a Right was exercisable immediately prior to such adjustment. Each Right held of record prior to such adjustment of the number of Rights shall become that number of Rights (calculated to the nearest one hundredth) obtained by dividing the Purchase Price in effect immediately prior to adjustment of the Purchase Price by the Purchase Price in effect immediately after adjustment of the Purchase Price. The Company shall make a public announcement of its election to adjust the number of Rights, indicating the record date for the adjustment, and, if known at the time, the amount of the adjustment to be made. This record date may be the date on which the Purchase Price is adjusted or any day thereafter, but, if the Rights Certificates have been issued, shall be at least ten days later than the date of such public announcement. If Rights Certificates have been issued, upon each adjustment of the number of Rights pursuant to this Section 11(i), the Company shall, as promptly as practicable, cause to be distributed to holders of record of Rights Certificates on such record date Rights Certificates evidencing, subject to Section 14 hereof, the additional Rights to which such holders shall be entitled as a result of such adjustment, or, at the option of the Company, shall cause to be distributed to such holders of record in substitution and replacement for the Rights Certificates held by such holders prior to the date of adjustment, and upon surrender thereof, if required by the Company, new Rights Certificates evidencing all the Rights to which such holders shall be entitled after such adjustment. Rights Certificates to be so distributed shall be issued, executed and countersigned in the manner provided for herein (and may bear, at the option of the Company, the adjusted Purchase Price) and shall be registered in the names of the holders of record of Rights Certificates on the record date specified in the public announcement.

(j) Irrespective of any adjustment or change in the Purchase Price or the number of Units of Preferred Stock issuable upon the exercise of the Rights, the Rights Certificates theretofore and thereafter issued may continue to express the Purchase Price per Unit and the number of Units of Preferred Stock which were expressed in the initial Rights Certificates issued hereunder.

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(k) Before taking any action that would cause an adjustment reducing the Purchase Price below the then par value of the Units of Preferred Stock or other shares of capital stock issuable upon exercise of the Rights, the Company shall take any corporate action which may, in the opinion of its counsel, be necessary in order that the Company may validly and legally issue such fully paid and non-assessable Units of Preferred Stock or other such shares at such adjusted Purchase Price.

(l) In any case in which this Section 11 shall require that an adjustment in the Purchase Price be made effective as of a record date for a specified event, the Company may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date of that number of Units of Preferred Stock and shares of other capital stock or securities of the Company, if any, issuable upon such exercise over and above the number of Units of Preferred Stock and shares of other capital stock or securities of the Company, if any, issuable upon such exercise on the basis of the Purchase Price in effect prior to such adjustment; PROVIDED, HOWEVER, that the Company shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional shares (fractional or otherwise) or securities upon the occurrence of the event requiring such adjustment.

(m) Anything in this Section 11 to the contrary notwithstanding, the Company shall be entitled to make such reductions in the Purchase Price, in addition to those adjustments expressly required by this Section 11, as and to the extent that in their good faith judgment a majority of the Board of Directors shall determine to be advisable in order that any (i) consolidation or subdivision of the Preferred Stock, (ii) issuance wholly for cash of any shares of Preferred Stock at less than the current market price, (iii) issuance wholly for cash of shares of Preferred Stock or securities which by their terms are convertible into or exchangeable for shares of Preferred Stock, (iv) stock dividends or (v) issuance of rights,

options or warrants referred to in this Section 11, hereafter made by the Company to holders of its Preferred Stock, shall not be taxable to such holders or shall reduce the taxes payable by such holders.

(n) The Company shall not, at any time after the Distribution Date, (i) consolidate with any other Person, (ii) merge with or into any other Person, or (iii) sell or transfer (or permit any Subsidiary to sell or transfer), in one transaction, or a series of transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Company and/or any of its wholly owned Subsidiaries in one or more transactions each of which complies with Section 11(o) hereof), if (x) at the time of or immediately after such consolidation, merger or sale there are any rights, warrants or other instruments or securities outstanding or agreements in effect which would substantially diminish or otherwise eliminate the benefits intended to be afforded by the Rights or (y) prior to, simultaneously with or immediately after such consolidation, merger or sale, the Person which constitutes, or would constitute, the "Principal Party" for purposes of Section 13(a) hereof shall have distributed or otherwise transferred to its shareholders or other persons holding an equity interest in such Person Rights previously owned by such Person or any of its Affiliates and Associates; PROVIDED, HOWEVER, this

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Section 11(n) shall not affect the ability of any wholly owned Subsidiary of the Company to consolidate with, merge with or into, or sell or transfer assets or earning power to, any other wholly owned Subsidiary of the Company.

(o) After the Distribution Date, the Company shall not, except as permitted by Section 23, Section 26 or Section 34 hereof, take (or permit any Subsidiary to take) any action if at the time such action is taken it is reasonably foreseeable that such action will diminish substantially or otherwise eliminate the benefits intended to be afforded by the Rights.

(p) Anything in this Agreement to the contrary notwithstanding, in the event that the Company shall at any time after the Rights Dividend Declaration Date and prior to the Distribution Date (i) declare a dividend on the outstanding shares of Company Common Stock payable in shares of Company Common Stock, (ii) subdivide the outstanding shares of Company Common Stock, (iii) combine the outstanding shares of Company Common Stock into a smaller number of shares, or (iv) issue any shares of its capital stock in a reclassification of Company Common Stock (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing or surviving corporation), the number of Rights associated with each share of Company Common Stock then outstanding, or issued or delivered thereafter prior to the Distribution Date or in accordance with Section 22 hereof, shall be proportionately adjusted so that the number of Rights thereafter associated with each share of Company Common Stock following any such event shall equal the result obtained by multiplying the number of Rights associated with each share of Company Common Stock immediately prior to such event by a fraction the numerator of which shall be the total number of shares of Company Common Stock outstanding immediately prior to the occurrence of the event and the denominator of which shall be the total number of shares of Company Common Stock outstanding immediately following the occurrence of such event.

Section 12. CERTIFICATE OF ADJUSTED PURCHASE PRICE OR NUMBER OF SHARES. Whenever an adjustment is made as provided in Section 11 or Section 13 hereof, the Company shall (a) promptly prepare a certificate setting forth such adjustment and a brief statement of the facts accounting for such adjustment, (b) promptly file with the Rights Agent, and with each transfer agent for the Preferred Stock and the Company Common Stock, a copy of such certificate, and (c) mail a brief summary thereof to each holder of a Rights Certificate (or, if prior to the Distribution Date, to each holder of a certificate representing shares of Company Common Stock) in accordance with Section 25 hereof. The Rights Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained and shall not be deemed to have knowledge of any such adjustment unless and until it shall have received such certificate.

Section 13. CONSOLIDATION, MERGER OR SALE OR TRANSFER OF ASSETS OR EARNING

POWER. (a) In the event that, following the first occurrence of a Section 11(a)(ii) Event, directly or indirectly, either (x) the Company shall consolidate with, or merge with and into, any other Person, and the Company shall not be the continuing or surviving corporation of such consolidation or merger, (y) any Person shall consolidate with, or merge with or into, the Company, and the Company

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shall be the continuing or surviving corporation of such consolidation or merger and, in connection with such consolidation or merger, all or part of the outstanding shares of Company Common Stock shall be changed into or exchanged for stock or other securities of the Company or any other Person or cash or any other property, or (z) the Company shall sell or otherwise transfer (or one or more of its Subsidiaries shall sell or otherwise transfer) to any Person or Persons (other than the Company or any of its wholly owned Subsidiaries in one or more transactions each of which complies with Section 11(o) hereof), in one or more transactions, assets or earning power aggregating 50% or more of the assets or earning power of the Company and its Subsidiaries (taken as a whole) (any such event being a "SECTION 13 EVENT"), then, and in each such case, proper provision shall be made so that: (i) each holder of a Right (other than Rights which have become void as provided in Section 7(e) hereof), shall thereafter have the right to receive, upon the exercise thereof at the Purchase Price (as theretofore adjusted in accordance with Section 11(a)(ii) hereof), in accordance with the terms of this Agreement and in lieu of Units of Preferred Stock or shares of Company Common Stock, such number of validly authorized and issued, fully paid, non-assessable and freely tradeable shares of Common Stock of the Principal Party (as such term is hereinafter defined), which shares shall not be subject to any liens, encumbrances, rights of call or first refusal, transfer restrictions or other adverse claims, as shall be equal to the result obtained by dividing the Purchase Price (as theretofore adjusted in accordance with Section 11(a)(ii) hereof) by 50% of the current market price (determined pursuant to Section 11(d) hereof) per share of the Common Stock of such Principal Party on the date of consummation of such Section 13 Event; PROVIDED, HOWEVER, that the Purchase Price (as theretofore adjusted in accordance with Section 11(a)(ii) hereof) and the number of shares of Common Stock of such Principal Party so receivable upon exercise of a Right shall be subject to further adjustment as appropriate in accordance with Section 11(f) hereof to reflect any events occurring in respect of the Common Stock of such Principal Party after the occurrence of such Section 13 Event; (ii) such Principal Party shall thereafter be liable for, and shall assume, by virtue of such Section 13 Event, all the obligations and duties of the Company pursuant to this Agreement; (iii) the term "Company" shall thereafter be deemed to refer to such Principal Party in all respects; (iv) such Principal Party shall take such steps (including, but not limited to, the reservation of a sufficient number of shares of its Common Stock in accordance with Section 9 hereof) in connection with the consummation of any such transaction as may be necessary to assure that the provisions of this Agreement shall thereafter be applicable, as nearly as reasonably may be, in relation to its shares of Common Stock thereafter deliverable upon the exercise of the Rights to its shares of Common Stock; PROVIDED, HOWEVER, that, upon the subsequent occurrence of any merger, consolidation, sale of all or substantially all of the assets, recapitalization, reclassification of shares, reorganization or other extraordinary transaction in respect of such Principal Party, each holder of a Right shall thereupon be entitled to receive, upon exercise of a Right and payment of the Purchase Price, such cash, shares, rights, warrants and other property which such holder would have been entitled to receive had it, at the time of such transaction, owned the shares of Common Stock of the Principal Party purchasable upon the exercise of a Right, and such Principal Party shall take such steps (including, but not limited to, reservation of shares of stock) as may be necessary to permit the subsequent exercise of the Rights in accordance with the terms hereof for such cash, shares, rights, warrants and other property; and (v) the provisions of Section 11(a)(ii) hereof shall be of no further effect following the first occurrence of any Section 13 Event.

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(b) "Principal Party" shall mean:

(i) in the case of any transaction described in clause (x) or (y) of the first sentence of Section 13(a) hereof, (A) the Person

that is the issuer of any securities into which shares of Company Common Stock are converted in such merger or consolidation, or, if there is more than one such issuer, the issuer of Common Stock that has the highest aggregate current market price (determined pursuant to Section 11(d) hereof) and (B) if no securities are so issued, the Person that is the other party to such merger or consolidation, or, if there is more than one such Person, the Person the Common Stock of which has the highest aggregate current market price (determined pursuant to Section 11(d) hereof); and

(ii) in the case of any transaction described in clause (z) of the first sentence of Section 13(a), the Person that is the party receiving the largest portion of the assets or earning power transferred pursuant to such transaction or transactions, or, if each Person that is a party to such transaction or transactions receives the same portion of the assets or earning power transferred pursuant to such transaction or transactions or if the Person receiving the largest portion of the assets or earning power cannot be determined, whichever Person the Common Stock of which has the highest aggregate current market price (determined pursuant to Section 11(d) hereof); PROVIDED, HOWEVER, that in any such case, (1) if the Common Stock of such Person is not at such time and has not been continuously over the preceding twelve-month period registered under Section 12 of the Exchange Act ("REGISTERED COMMON STOCK"), or such Person is not a corporation, and such Person is a direct or indirect Subsidiary of another Person that has Registered Common Stock outstanding, "Principal Party" shall refer to such other Person; (2) if the Common Stock of such Person is not Registered Common Stock or such Person is not a corporation, and such Person is a direct or indirect Subsidiary of another Person but is not a direct or indirect Subsidiary of another Person which has Registered Common Stock outstanding, "Principal Party" shall refer to the ultimate parent entity of such first-mentioned Person; (3) if the Common Stock of such Person is not Registered Common Stock or such Person is not a corporation, and such Person is directly or indirectly controlled by more than one Person, and one or more of such other Persons has Registered Common Stock outstanding, "Principal Party" shall refer to whichever of such other Persons is the issuer of the Registered Common Stock having the highest aggregate current market price (determined pursuant to Section 11(d) hereof); and (4) if the Common Stock of such Person is not Registered Common Stock or such Person is not a corporation, and such Person is directly or indirectly controlled by more than one Person, and none of such other Persons have Registered Common Stock outstanding, "Principal Party" shall refer to whichever ultimate parent entity is the corporation having the greatest stockholders equity or, if no such ultimate parent entity is a corporation, shall refer to whichever ultimate parent entity is the entity having the greatest net assets.

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(c) The Company shall not consummate any such consolidation, merger, sale or transfer unless the Principal Party shall have a sufficient number of authorized shares of its Common Stock which have not been issued or reserved for issuance to permit the exercise in full of the Rights in accordance with this Section 13, and unless prior thereto the Company and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing for the terms set forth in paragraphs (a) and (b) of this Section 13 and further providing that the Principal Party, at its own expense, shall:

(i) (A) file on an appropriate form, as soon as practicable following the execution of such agreement, a registration statement under the Securities Act with respect to the Common Stock that may be acquired upon exercise of the Rights, (B) cause such registration statement to remain effective (and to include a prospectus complying with the requirements of the Securities Act) until the Expiration Date, and (C) as soon as practicable following the execution of such agreement, take such action as may be required to assure that any acquisition of such Common Stock upon the exercise of the Rights complies with any applicable state securities or "blue sky" laws; and

(ii) as soon as practicable following the execution of such

agreement, deliver to holders of the Rights historical financial statements for the Principal Party and each of its Affiliates which comply in all respects with the requirements for registration on Form 10 under the Exchange Act.

(d) In case the Principal Party which is to be a party to a transaction referred to in this Section 13 has a provision in any of its authorized securities or in its certificate of incorporation or bylaws or other instrument governing its corporate affairs, which provision would have the effect of (i) causing such Principal Party to issue, in connection with, or as a consequence of, the consummation of a transaction referred to in this Section 13, shares of Common Stock of such Principal Party at less than the then current market price per share (determined pursuant to Section 11(d) hereof) or securities exercisable for, or convertible into, Common Stock of such Principal Party at less than such then current market price (other than to holders of Rights pursuant to this Section 13) or (ii) providing for any special payment, tax or similar provisions in connection with the issuance of the Common Stock of such Principal Party pursuant to the provisions of this Section 13; then, in such event, the Company shall not consummate any such transaction unless prior thereto the Company and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing that the provision in question of such Principal Party shall have been canceled, waived or amended, or that the authorized securities shall be redeemed, so that the applicable provision will have no effect in connection with, or as a consequence of, the consummation of the proposed transaction.

(e) The provisions of this Section 13 shall similarly apply to successive mergers or consolidations or sales or other transfers. In the event that a Section 13 Event shall occur at any time after the occurrence of a Section 11(a) (ii) Event, the Rights that have

not theretofore been exercised shall thereafter become exercisable in a manner and for the securities described in Section 13(a).

Section 14. FRACTIONAL RIGHTS AND FRACTIONAL SHARES. (a) The Company shall not be required to issue fractions of Rights or to distribute Rights Certificates which evidence fractional Rights. In lieu of issuing such fractional Rights, there shall be paid to the Persons to which such fractional Rights would otherwise be issuable, an amount in cash equal to such fraction of the market value of a whole Right. For purposes of this Section 14(a), the market value of a whole Right shall be the closing price of the Rights for the Trading Day immediately prior to the date on which such fractional Rights would have been otherwise issuable. The closing price of the Rights for any day shall be, if the Rights are listed or admitted to trading on a national securities exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Rights are listed or admitted to trading or, if the Rights are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by Nasdaq or such other system then in use or, if on any such date the Rights are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Rights selected by a majority of the Board of Directors. If on any such date no such market maker is making a market in the Rights, the fair value of the Rights on such date as determined in good faith by a majority of the Board of Directors shall be used and such determination shall be described in a statement filed with the Rights Agent and the holders of the Rights.

(b) The Company shall not be required to issue fractions of shares of Preferred Stock (other than fractions which are integral multiples of one one-thousandth of a share of Preferred Stock) upon exercise of the Rights or to distribute certificates which evidence such fractional shares of Preferred Stock (other than fractions which are integral multiples of one one-thousandth of a share of Preferred Stock); PROVIDED, HOWEVER, that in lieu of fractions of shares of Preferred Stock which are integral multiples of one one-thousandth of a share of Preferred Stock, the Company may provide for the issuance of depository receipts pursuant to Section 7(c) hereof. In lieu of such fractional shares of Preferred Stock that are not integral multiples of one one-thousandth of a share, the Company may pay to the registered holders of Rights Certificates

at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the then current market price of a share of Preferred Stock on the day of exercise, determined in accordance with Section 11(d) hereof.

(c) The holder of a Right by the acceptance of the Rights expressly waives his right to receive any fractional Rights or any fractional shares upon exercise of a Right, except as permitted by this Section 14.

Section 15. RIGHTS OF ACTION. All rights of action in respect of this Agreement, other than rights of action vested in the Rights Agent pursuant to Section 18 hereof, are vested in the respective registered holders of the Rights Certificates (and, prior to the Distribution Date, the registered holders of certificates representing shares of Company Common Stock); and any registered holder of a Rights Certificate (or, prior to the Distribution Date, of a certificate representing shares of Company Common Stock), without the consent of the Rights Agent or of

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the holder of any other Rights Certificate (or, prior to the Distribution Date, of a certificate representing shares of Company Common Stock), may, in his own behalf and for his own benefit, enforce, and may institute and maintain any suit, action or proceeding against the Company or any other Person to enforce, or otherwise act in respect of, his right to exercise the Rights evidenced by such Rights Certificate in the manner provided in such Rights Certificate and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights, it is specifically acknowledged that the holders of Rights would not have an adequate remedy at law for any breach of this Agreement and shall be entitled to specific performance of the obligations hereunder and injunctive relief against actual or threatened violations of the obligations hereunder of any Person subject to this Agreement.

Section 16. AGREEMENT OF RIGHTS HOLDERS. Every holder of a Right by accepting the same consents and agrees with the Company and the Rights Agent and with every other holder of a Right that:

(a) prior to the Distribution Date, the Rights will be transferable only in connection with the transfer of Company Common Stock;

(b) after the Distribution Date, the Rights Certificates are transferable only on the registry books of the Rights Agent if surrendered at the office of the Rights Agent designated for such purposes, duly endorsed or accompanied by a proper instrument of transfer and with the appropriate forms and certificates duly executed;

(c) subject to Section 6(a) and Section 7(f) hereof, the Company and the Rights Agent may deem and treat the person in whose name a Rights Certificate (or, prior to the Distribution Date, the associated Company Common Stock certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on the Rights Certificates or the associated Company Common Stock certificate made by anyone other than the Company or the Rights Agent) for all purposes whatsoever, and neither the Company nor the Rights Agent, subject to the last sentence of Section 7 (e) hereof, shall be affected by any notice to the contrary; and

(d) notwithstanding anything in this Agreement to the contrary, neither the Company nor the Rights Agent shall have any liability to any holder of a Right or any other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree or ruling issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation; PROVIDED, HOWEVER, the Company must use its best efforts to have any such order, decree or ruling lifted or otherwise overturned as promptly as practicable.

Section 17. RIGHTS CERTIFICATE HOLDER NOT DEEMED A STOCKHOLDER. No holder, as such, of any Rights Certificate shall be entitled to vote, receive dividends or be deemed for any purpose the

holder of the number of shares of Preferred Stock or any other securities of the Company which may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or in any Rights Certificate be construed to confer upon the holder of any Rights Certificate, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or, except as provided in Section 24 hereof, to receive notice of meetings or other actions affecting stockholders, or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by such Rights Certificate shall have been exercised in accordance with the provisions hereof. This Section 17 shall also apply to holders, as such, of Rights prior to the issuance of Rights Certificates.

Section 18. CONCERNING THE RIGHTS AGENT. (a) The Company agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder and, from time to time, on demand of the Rights Agent, its reasonable expenses, including reasonable fees and disbursements of its counsel, incurred in connection with the execution and administration of this Agreement and the exercise and performance of its duties hereunder. The Company shall indemnify the Rights Agent for, and hold it harmless against, any loss, liability, or expense, incurred without negligence, bad faith or willful misconduct on the part of the Rights Agent, for anything done or omitted by the Rights Agent in connection with the acceptance and administration of this Agreement, including the reasonable costs and expenses of defending against any claim of liability hereunder.

(b) The Rights Agent shall be protected and shall incur no liability for or in respect of any action taken, suffered or omitted by it in connection with its administration of this Agreement in reliance upon any Rights Certificate or certificate for Preferred Stock or for other securities of the Company, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter, notice, direction, consent, certificate, statement or other paper or document believed by it to be genuine and to have been signed, executed and, where necessary, verified or acknowledged by the proper Person or Persons.

Section 19. MERGER OR CONSOLIDATION OR CHANGE OF NAME OF RIGHTS AGENT. (a) Any corporation into which the Rights Agent or any successor Rights Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, or any corporation succeeding to the corporate trust or shareholder services businesses of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any document or any further act on the part of any of the parties hereto; PROVIDED, HOWEVER, that such corporation would be eligible for appointment as a successor Rights Agent under the provisions of Section 21 hereof. In case at the time such successor Rights Agent shall succeed to the agency created by this Agreement, any of the Rights Certificates shall have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of a predecessor Rights Agent and deliver such Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, any successor Rights Agent may countersign such Rights Certificates either in the name of the predecessor or in the name of the successor Rights Agent; and in all such cases such

Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

(b) In case at any time the name of the Rights Agent shall be changed and at such time any of the Rights Certificates shall have been countersigned but not delivered, the Rights Agent may adopt the countersignature under its prior name and deliver Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, the Rights Agent may countersign such Rights Certificates either in its prior name or in its changed name; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

Section 20. DUTIES OF RIGHTS AGENT. The Rights Agent undertakes the duties and obligations imposed by this Agreement upon the following terms and conditions, by all of which the Company and the holders of Rights Certificates, by their acceptance thereof, shall be bound:

(a) The Rights Agent may consult with legal counsel (who may be legal counsel for the Company), and the opinion of such counsel shall be full and complete authorization and protection to the Rights Agent as to any action taken or omitted by it in good faith and in accordance with such opinion.

(b) Whenever in the performance of its duties under this Agreement the Rights Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of any Acquiring Person and the determination of "current market price") be proved or established by the Company prior to taking or suffering any action hereunder, such fact or matter (unless other evidence in respect thereof be specified herein) may be deemed to be conclusively proved and established by a certificate signed by the Chairman, the Vice Chairman, the Chief Executive Officer, the President, the Chief Financial Officer, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Company and delivered to the Rights Agent; PROVIDED, HOWEVER, that so long as any Person is an Acquiring Person hereunder, such certificate shall be signed and delivered by a majority of the Board of Directors; and such certificate shall be full authorization to the Rights Agent for any action taken or suffered in good faith by it under the provisions of this Agreement in reliance upon such certificate.

(c) The Rights Agent shall be liable hereunder only for its own negligence, bad faith or willful misconduct.

(d) The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Rights Certificates or be required to verify the same (except as to its countersignature on such Rights Certificates), but all such statements and recitals are and shall be deemed to have been made by the Company only.

(e) The Rights Agent shall not have any responsibility for the validity of this Agreement or the execution and delivery hereof (except the due execution hereof by the

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Rights Agent) or for the validity or execution of any Rights Certificate (except its countersignature thereof); nor shall it be responsible for any breach by the Company of any covenant or failure by the Company to satisfy conditions contained in this Agreement or in any Rights Certificate; nor shall it be responsible for any adjustment required under the provisions of Section 11 or Section 13 hereof or for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect to the exercise of Rights evidenced by Rights Certificates after receipt by the Rights Agent of the certificate describing any such adjustment contemplated by Section 12); nor shall it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any shares of Preferred Stock or any other securities to be issued pursuant to this Agreement or any Rights Certificate or as to whether any shares of Preferred Stock or any other securities will, when so issued, be validly authorized and issued, fully paid and non-assessable.

(f) The Company shall perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further acts, instruments and assurances as may reasonably be required by the Rights Agent for the performance by the Rights Agent of its duties under this Agreement.

(g) The Rights Agent is hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from the Chairman, the Vice Chairman, the Chief Executive Officer, the President, the Chief Financial Officer, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant Treasurer of the Company, and to apply to such officers for advice or instructions in

connection with its duties, and it shall not be liable for any action taken or suffered to be taken by it in good faith in accordance with instructions of any such officer; PROVIDED, HOWEVER, that so long as any Person is an Acquiring Person hereunder, the Rights Agent shall accept such instructions and advice only from a majority of the Board of Directors and shall not be liable for any action taken or suffered to be taken by it in good faith in accordance with such instructions of a majority of the Board of Directors. Any application by the Rights Agent for written instructions from the Company may, at the option of the Rights Agent, set forth in writing any action proposed to be taken or omitted by the Rights Agent under this Rights Agreement and the date on and/or after which such action shall be taken or such omission shall be effective. The Rights Agent shall not be liable for any action taken by, or omission of, the Rights Agent in accordance with a proposal included in any such application on or after the date specified in such application (which date shall not be less than five Business Days after the date any such officer of the Company actually receives such application, unless any such officer shall have consented in writing to an earlier date) unless, prior to taking any such action (or the effective date in the case of an omission), the Rights Agent shall have received written instructions in response to such application specifying the action to be taken or omitted.

(h) The Rights Agent and any shareholder, director, officer or employee of the Rights Agent may buy, sell or deal in any of the Rights or other securities of the Company or have a pecuniary interest in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and

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freely as though it were not Rights Agent under this Agreement. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Company or for any other legal entity.

(i) The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Company resulting from any such act, default, neglect or misconduct; provided, however, reasonable care was exercised in the selection and continued employment thereof.

(j) No provision of this Agreement shall require the Rights Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties or in the exercise of its rights hereunder if the Rights Agent shall have reasonable grounds for believing that repayment of such funds or adequate indemnification against such risk or liability is not reasonably assured to it.

(k) If, with respect to any Rights Certificate surrendered to the Rights Agent for exercise or transfer, the certificate attached to the form of assignment or form of election to purchase, as the case may be, has either not been completed, not signed or indicates an affirmative response to clause 1 and/or 2 thereof, the Rights Agent shall not take any further action with respect to such requested exercise or transfer without first consulting with the Company. If such certificate has been completed and signed and shows a negative response to clauses 1 and 2 of such certificate, unless previously instructed otherwise in writing by the Company (which instructions may impose on the Rights Agent additional ministerial responsibilities, but no discretionary responsibilities), the Rights Agent may assume without further inquiry that the Rights Certificate is not owned by a Person described in Section 7(e) hereof and shall not be charged with any knowledge to the contrary.

Section 21. CHANGE OF RIGHTS AGENT. The Rights Agent or any successor Rights Agent may resign and be discharged from its duties under this Agreement upon thirty days' prior notice in writing mailed to the Company, and to each transfer agent of the Preferred Stock and the Company Common Stock, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. The Company may remove the Rights Agent or any successor Rights Agent upon thirty days' prior notice in writing, mailed to the Rights Agent or successor Rights Agent, as the case may be, and to each transfer agent of the Preferred Stock and the Company Common Stock, by registered or certified

mail, and to the holders of the Rights Certificates by first-class mail. If the Rights Agent shall resign or be removed or shall otherwise become incapable of acting, the Company shall appoint a successor to the Rights Agent. If the Company shall fail to make such appointment within a period of thirty days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of a Rights Certificate (who shall, with such notice, submit his Rights Certificate for inspection by the Company), then any registered holder of any Rights Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the

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Company or by such a court, shall be (a) a corporation organized and doing business under the laws of the United States or any state of the United States in good standing, shall be authorized under applicable laws to exercise corporate trust or stock transfer powers and shall be subject to supervision or examination by federal or state authorities or (b) an Affiliate of a corporation described in clause (a). After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Rights Agent without further act or deed; but the predecessor Rights Agent shall deliver and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Company shall file notice thereof in writing with the predecessor Rights Agent and each transfer agent of the Preferred Stock and the Company Common Stock, and mail a notice thereof in writing to the registered holders of the Rights Certificates. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent.

Section 22. ISSUANCE OF NEW RIGHTS CERTIFICATES. Notwithstanding any of the provisions of this Agreement or the Rights to the contrary, the Company may, at its option, issue new Rights Certificates evidencing Rights in such form as may be approved by a majority of the Board of Directors to reflect any adjustment or change made in accordance with the provisions of this Agreement in the Purchase Price or the number or kind or class of shares or other securities or property that may be acquired under the Rights Certificates. In addition, in connection with the issuance or sale of shares of Company Common Stock following the Distribution Date and prior to the Expiration Date, the Company (a) shall, with respect to shares of Company Common Stock so issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, or upon the exercise, conversion or exchange of securities hereinafter issued by the Company, and (b) may, in any other case, if deemed necessary or appropriate by a majority of the Board of Directors, issue Rights Certificates representing the appropriate number of Rights in connection with such issuance or sale; PROVIDED, HOWEVER, that (i) no such Rights Certificate shall be issued if, and to the extent that, the Company shall be advised by counsel that such issuance would create a significant risk of material adverse tax consequences to the Company or the Person to whom such Rights Certificate would be issued, and (ii) no such Rights Certificate shall be issued if, and to the extent that, appropriate adjustment shall otherwise have been made in lieu of the issuance thereof.

Section 23. REDEMPTION AND TERMINATION. (a) Subject to Section 30 hereof, the Company may, at its option, by action of a majority of the Board of Directors, at any time prior to the earlier of (i) the Close of Business on the tenth Business Day following the Stock Acquisition Date or (ii) the Final Expiration Date, redeem all but not less than all of the then outstanding Rights at a redemption price of \$.01 per Right, as such amount may be appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being the "REDEMPTION PRICE"). The Company may, at its option, by action of a majority of the Board of Directors, pay the Redemption Price either in shares of Company Common Stock (based on the "current market price", as defined in Section 11(d) hereof, of the shares of Company Common Stock at the time of redemption) or cash and the

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redemption of the Rights shall be effective on the basis and with such

conditions as the Board of Directors may in its sole discretion establish.

(b) Immediately upon the action of a majority of the Board of Directors ordering the redemption of the Rights, evidence of which shall be filed with the Rights Agent, and without any further action and without any notice, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price for each Right so held. The Company shall promptly give public notice of any such redemption; PROVIDED, HOWEVER, that the failure to give, or any defect in, any such notice shall not affect the validity of such redemption. Promptly after the action of a majority of the Board of Directors ordering the redemption of the Rights, the Company shall give notice of such redemption to the Rights Agent and the holders of the then outstanding Rights by mailing such notice to all such holders at each holder's last address as it appears upon the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the transfer agent for the Company Common Stock. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made.

Section 24. NOTICE OF CERTAIN EVENTS. (a) In case the Company shall propose, at any time after the Distribution Date, (i) to pay any dividend payable in stock of any class to the holders of Preferred Stock or to make any other distribution to the holders of Preferred Stock (other than a regular quarterly cash dividend paid out of funds legally available therefor), (ii) to offer to the holders of Preferred Stock rights or warrants to subscribe for or to purchase any additional shares of Preferred Stock or shares of stock of any class or any other securities, rights or options, (iii) to effect any reclassification of its Preferred Stock (other than a reclassification involving only the subdivision of outstanding shares of Preferred Stock), (iv) to effect any consolidation or merger into or with any other Person, or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer), in one or more transactions, of more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons (other than a transfer by the Company and/or any of its wholly owned Subsidiaries in one or more transactions each of which complies with Section 11(o) hereof), or (v) to effect the liquidation, dissolution or winding up of the Company, then, in each such case, the Company shall give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 25 hereof, a notice of such proposed action, which shall specify the record date for the purposes of such stock dividend, distribution of rights or warrants, or the date on which such reclassification, consolidation, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of the shares of Preferred Stock, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least twenty (20) days prior to the record date for determining holders of th shares of Preferred Stock for purposes of such action, and in the case of any such other action, at least twenty (20) days prior to the date of the taking of such proposed action or the date of participation therein by the holders of the shares of Preferred Stock whichever shall be the earlier; PROVIDED, HOWEVER, no such notice shall be required pursuant to this Section 24, if any wholly owned Subsidiary of the Company effects a consolidation or merger with or into, or effects a sale or other transfer of assets or earnings power to, any other wholly owned Subsidiary of the Company.

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(b) In case any Triggering Event shall occur, then, in any such case, (i) the Company shall as soon as practicable thereafter give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 25 hereof, a notice of the occurrence of such event, which shall specify the event and the consequences of the event to holders of Rights under Section 11(a) (ii) or Section 13 hereof, as the case may be.

Section 25. NOTICES. All notices and other communications provided for hereunder shall, unless otherwise stated herein, be in writing (including by telex, telegram or cable) and mailed or sent or delivered, if to the Company, at its address at:

DSP Group, Inc.
3120 Scott Boulevard
Santa Clara, California 95054

Attention: President

and if to the Rights Agent, at its address at:

Norwest Bank Minnesota, N.A.
161 North Concord Exchange
South St. Paul, Minnesota 55075
Attention: Shareowner Services Department

Notices or demands authorized by this Agreement to be given or made by the Company or the Rights Agent to the holder of any Rights Certificate (or, if prior to the Distribution Date, to the holder of certificates representing shares of Company Common Stock) shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Company.

Section 26. SUPPLEMENTS AND AMENDMENTS. Prior to the Distribution Date and subject to the penultimate sentence of this Section 26, the Company and the Rights Agent shall, if the Company so directs, supplement or amend any provision of this Agreement in any respect without the approval of any holders of certificates representing shares of Company Common Stock. From and after the Distribution Date and subject to the penultimate sentence of this Section 26, the Company and the Rights Agent shall, if the Company so directs, supplement or amend this Agreement without the approval of any holders of Rights Certificates in order (i) to cure any ambiguity, (ii) to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, (iii) to shorten or lengthen any time period hereunder, or (iv) to change or supplement the provisions hereunder in any manner which the Company may deem necessary or desirable and which shall not adversely affect the interests of the holders of Rights Certificates (other than an Acquiring Person or an Affiliate or Associate of an Acquiring Person); PROVIDED, HOWEVER, that this Agreement may not be supplemented or amended to lengthen, pursuant to clause (iii) of this sentence, (A) subject to Section 30 hereof, a time period relating to when the Rights may be redeemed at such time as the Rights are not then redeemable, or (B) any other time period unless such lengthening is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to, the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Company or, so long as any Person is

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an Acquiring Person hereunder, from the majority of the Board of Directors which states that the proposed supplement or amendment is in compliance with the terms of this Section 26, the Rights Agent shall execute such supplement or amendment. Notwithstanding anything contained in this Agreement to the contrary, (i) no supplement or amendment shall be made which changes the Redemption Price, the Purchase Price, the Expiration Date or the number of Units of Preferred Stock or other securities or assets for which a Right is exercisable without the approval of a majority of the Board of Directors, and (ii) following the occurrence of a Section 11(a)(ii) Event, no supplement or amendment whatsoever shall be made without the approval of the Board of Directors. Prior to the Distribution Date, the interests of the holders of Rights shall be deemed coincident with the interests of the holders of Company Common Stock.

Section 27. SUCCESSORS. All the covenants and provisions of this Agreement by or for the benefit of the Company or the Rights Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

Section 28. DETERMINATIONS AND ACTIONS BY THE BOARD OF DIRECTORS, ETC. For all purposes of this Agreement, any calculation of the number of shares of Company Common Stock outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding shares of Company Common Stock of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the Exchange Act Regulations as in effect on the date hereof. Except as otherwise specifically provided herein, the Board of Directors of the Company shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to the Board of Directors or to the Company, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power (i) to interpret the provisions of this Agreement, and (ii) to make all determinations deemed necessary or advisable for the administration of this Agreement. All such actions, calculations, interpretations and determinations (including, for

purposes of clause (y) below, all omissions with respect to the foregoing) which are done or made by the Board of Directors in good faith shall (x) be final, conclusive and binding on the Company, the Rights Agent, the holders of the Rights and all other parties, and (y) not subject the Board or any member thereof to any liability to the holders of the Rights.

Section 29. BENEFITS OF THIS AGREEMENT. Nothing in this Agreement shall be construed to give to any Person other than the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of shares of Company Common Stock) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of shares of Company Common Stock).

Section 30. SEVERABILITY. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; PROVIDED, HOWEVER, that notwithstanding anything in this Agreement to the contrary,

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if any such term, provision, covenant or restriction is held by such court or authority to be invalid, void or unenforceable and a majority of the Board of Directors determines in its good faith judgment that severing the invalid language from this Agreement would adversely affect the purpose or effect of this Agreement and the Rights shall not then be redeemable, the right of redemption set forth in Section 23 hereof shall be reinstated and shall not expire until the Close of Business on the tenth Business Day following the date of such determination by a majority of the Board of Directors.

Section 31. GOVERNING LAW. This Agreement, each Right and each Rights Certificate issued hereunder shall be governed by, and construed in accordance with, the laws of the State of Delaware applicable to contracts executed in and to be performed entirely in such State.

Section 32. COUNTERPARTS. This Agreement may be executed (including by facsimile) in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original, but all of which taken together shall constitute one and the same instrument.

Section 33. DESCRIPTIVE HEADINGS. The headings contained in this Agreement are for descriptive purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 34. EXCHANGE. (a) The Company, upon resolution of a majority of the Board of Directors may, at its option, at any time after the first occurrence of a Section 11(a)(ii) Event, exchange all or part of the then outstanding and exercisable Rights (which shall not include Rights that have become void pursuant to Section 7(e) hereof) for Units of Preferred Stock or shares of Company Common Stock (at the election of the Board of Directors) at an exchange ratio of one Unit of Preferred Stock or one share of Company Common Stock, as the case may be, per Right, as appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such exchange ratio being the "EXCHANGE RATIO"). Notwithstanding the foregoing, the Board of Directors shall not be empowered to effect such exchange at any time after any Person (other than an Exempt Person), together with all Affiliates and Associates of such Person, becomes the Beneficial Owner of shares of Company Common Stock aggregating 50% or more of the shares of Company Common Stock then outstanding. From and after the occurrence of a Section 13(a) Event, any Rights that theretofore have not been exchanged pursuant to this Section 34(a) shall thereafter be exercisable only in accordance with Section 13 and may not be exchanged pursuant to this Section 34(a). The exchange of the Rights by the Board of Directors may be made effective at such time, on such basis and with such conditions as the Board of Directors in its sole discretion may establish.

(b) Immediately upon the action of a majority of the Board of Directors ordering the exchange of any Rights pursuant to Section 34(a) and

without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of a holder of such Rights shall be to receive that number of Units of Preferred Stock or shares of Company Common Stock, as the case may be, equal to the number of such Rights held by such holder multiplied by the Exchange Ratio. The Company shall promptly give public notice of any such exchange; PROVIDED, HOWEVER, that the failure to give, or any defect in, such notice shall not

affect the validity of such exchange. The Company promptly shall mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the Rights Agent. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange shall state the method by which the exchange of Units of Preferred Stock or shares of Company Common Stock, as the case may be, for Rights will be effected and, in the event of any partial exchange, the number of Rights which will be exchanged. Any partial exchange shall be effected pro rata based on the number of Rights (other than Rights which have become void pursuant to the provisions of Section 7(e) hereof) held by each holder of Rights.

(c) In the event that the number of shares of Preferred Stock or Company Common Stock, as the case may be, which are authorized by the Company's Restated Certificate of Incorporation but not outstanding or reserved for issuance for purposes other than upon exercise of the Rights are not sufficient to permit any exchange of Rights as contemplated in accordance with this Section 34, the Company, upon a resolution of a majority of the Board of Directors, shall take all such action as may be necessary to authorize additional shares of Preferred Stock or Company Common Stock, as the case may be, for issuance upon exchange of the Rights or make adequate provision to substitute, in whole or in part, (1) cash, (2) other equity securities of the Company, (3) debt securities of the Company, (4) other assets, or (5) any combination of the foregoing, having an aggregate value for each Right to be exchanged equal to the per share market price of one Unit of Preferred Stock or share of Company Common Stock, as the case may be (determined pursuant to Section 11(d) hereof) as of the date of a Section 11(a)(ii) Event, where such aggregate value has been determined by a majority of the Board of Directors.

(d) The Company shall not be required to issue fractions of Units of Preferred Stock or fractions of shares of Company Common Stock or to distribute certificates which evidence fractional Units or fractional shares. In lieu of issuing fractional Units or fractional shares, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exchanged as herein provided an amount in cash equal to the same fraction of the current market price (determined pursuant to Section 11(d) hereof) of one Unit of Preferred Stock or one share of Company Common Stock, as the case may be, on the Trading Day immediately prior to the date of exchange pursuant to this Section 34.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed, all as of the date first above written.

Attest: DSP GROUP, INC.

| | |
|--|---|
| By: /s/ Avi Basher | By: /s/ Eliyahu Ayalon |
| ----- | ----- |
| Name: Avi Basher | Name: Eliyahu Ayalon |
| Title: Vice President of Finance, Chief Financial Officer | Title: President and Chief Executive Officer |

and Secretary

Attest: NORWEST BANK MINNESOTA, N.A.

By: /s/ Karri L. VanDell By: /s/ John Baker

surrender at the office of the Rights Agent designated for such purpose, may be exchanged for another Rights Certificate or Rights Certificates of like tenor and date evidencing an aggregate number of Rights equal to the aggregate number of Rights evidenced by the Rights Certificate or Rights Certificates surrendered. If this Rights Certificate shall be exercised in part, the registered holder shall be entitled to receive, upon surrender hereof, another Rights Certificate or Rights Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Rights Agreement, the Rights evidenced by this Certificate may be (x) redeemed by the Company under certain circumstances at its option at a redemption price of \$.01 per Right, payable at the Company's option in cash or in common stock of the Company, subject to adjustment in certain events as provided in the Rights Agreement, or (y) exchanged for Units of Preferred Stock or shares of Common Stock of the Company or other consideration.

No fractional shares of Preferred Stock will be issued upon the exercise of any Right or Rights evidenced hereby (other than fractions which are integral multiples of one one-thousandth of a share of Preferred Stock or depositary receipts representing such fractions), but in lieu thereof a cash payment will be made, as provided in the Rights Agreement.

No holder of this Rights Certificate, as such, shall be entitled to vote or receive dividends or be deemed for any purpose the holder of Preferred Stock or of any other securities which may at any time be issuable on the exercise hereof, nor shall anything contained in the Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting stockholders (except as provided in the Rights Agreement), or to receive dividends of subscription rights, or otherwise, until the Rights

evidenced by this Rights Certificate shall have been exercised as provided in the Rights Agreement.

This Rights Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.

WITNESS the facsimile signature of the proper officers of the Company.
Dated as of _____, _____

DSP GROUP, INC.

By: _____
Name:
Title:

By: _____
Name:
Title:

Countersigned:

NORWEST BANK MINNESOTA, N.A.
as Rights Agent

By: _____

Name:
Title:

[Form of Reverse Side of Rights Certificate]

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Rights Certificate.)

FOR VALUE RECEIVED _____ hereby sells, assigns and transfers unto: _____ (Please print name and address of transferee) _____ this Rights Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint _____ Attorney, to transfer the within Rights Certificate on the books of the within-named Company, with full power of substitution.

Dated _____, 199

Signature

Signature Guaranteed:

CERTIFICATE

The undersigned hereby certifies by checking the appropriate boxes in (1) and (2) that:

(1) this Rights Certificate [] is [] is not being sold, assigned and transferred by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such terms are defined pursuant to the Rights Agreement); and

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or subsequently became an Acquiring Person or an Affiliate or Associate of an Acquiring Person.

Dated _____, 199

Signature

Signature Guaranteed:

NOTICE

The signature to the foregoing Assignment and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

Signatures must be guaranteed by an approved eligible financial institution acceptable to the Rights Agent in its sole discretion or by a participant in the Securities Transfer Agents Medallion Program, the Stock Exchange Medallion Program or the New York Stock Exchange Medallion Program.

In the event the certification set forth above is not completed, the Company will deem the beneficial owner of the Rights evidenced by this Rights Certificate to be an Acquiring Person or an Affiliate or Associate thereof (as defined in the Rights Agreement) and, in the case of an Assignment, will affix a

legend to that effect on any Rights Certificates issued in exchange for this Rights Certificate.

FORM OF ELECTION TO PURCHASE

(To be executed if the registered holder desires to exercise Rights represented by the Rights Certificate.)

To: DSP GROUP, INC.

The undersigned hereby irrevocably elects to exercise _____ Rights represented by this Rights Certificate to purchase the Units of Preferred Stock issuable upon the exercise of the Rights (or such other securities of the Company or of any other person or other property which may be issuable upon the exercise of the Rights) and requests that certificates for such Units be issued in the name of and delivered to: _____ (Please print name and address) _____ (Please insert social security or other identifying number).

If such number of Rights shall not be all the Rights evidenced by this Rights Certificate, a new Rights Certificate for the balance of such Rights shall be registered in the name of and delivered to:

(Please print name and address) _____
(Please insert social security or other identifying number).

Dated _____, 199

Signature

Signature Guaranteed:

CERTIFICATE

The undersigned hereby certifies by checking the appropriate boxes in (1) and (2) that:

(1) the Rights evidenced by this Rights Certificate [] are [] are not beneficially owned by an Acquiring Person or an Affiliate or an Associate thereof (as defined in the Rights Agreement); and

(2) after due inquiry and to the best knowledge of the undersigned, the undersigned [] did [] did not acquire the Rights evidenced by this Rights Certificate from any person who is, was or subsequently became an Acquiring Person or an Affiliate or Associate thereof.

Dated: _____, 199

Signature

Signature Guaranteed:

NOTICE

The signature in the foregoing Election to Purchase and Certificate must conform to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

Signatures must be guaranteed by an approved eligible financial institution

acceptable to the Rights Agent in its sole discretion or by a participant in the Securities Transfer Agents Medallion Program, the Stock Exchange Medallion Program or the New York Stock Exchange Medallion Program.

In the event the certification set forth above is not completed, the Company will deem the beneficial owner of the Rights evidenced by this Rights Certificate to be an Acquiring Person or an Affiliate or Associate thereof (as defined in the Rights Agreement) and, in the case of an Assignment, will affix a legend to that effect on any Rights Certificates issued in exchange for this Rights Certificate.

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EXHIBIT B

UNDER CERTAIN CIRCUMSTANCES
(SPECIFIED IN THE RIGHTS AGREEMENT),
RIGHTS BENEFICIALLY OWNED BY ACQUIRING PERSONS
(AS DEFINED IN THE RIGHTS AGREEMENT)
OR ANY SUBSEQUENT HOLDER OF SUCH RIGHTS
MAY BECOME NULL AND VOID.

SUMMARY OF RIGHTS TO PURCHASE PREFERRED STOCK

On June 5, 1997, the Board of Directors of DSP Group, Inc. (the "Company") authorized and declared a dividend distribution of one Right for each outstanding share of its common stock, par value \$.001 per share (the "Company Common Stock"), to stockholders of record at the close of business on June 10, 1997 (the "Record Date"), and authorized the issuance of one Right with each share of Company Common Stock issued (including shares distributed from Treasury) by the Company thereafter between the Record Date and the Distribution Date (as defined below). Each Right entitles the registered holder, subject to the terms of the Rights Agreement (as defined below), to purchase from the Company one one-thousandth of a share (a "Unit") of Series A Preferred Stock, par value \$.001 per share (the "Preferred Stock"), at a purchase price of \$70.00 per Unit, subject to adjustment. The purchase price is payable in cash or by certified or bank check or money order payable to the order of the Company. The description and terms of the Rights are set forth in a Rights Agreement between the Company and Norwest Bank Minnesota, N.A., as Rights Agent, dated as of June 5, 1997, as amended from time to time (the "Rights Agreement").

Copies of the Rights Agreement and the Certificate of Designation for the Preferred Stock have been filed with the Securities and Exchange Commission as exhibits to a Registration Statement on Form 8-A dated June 6, 1997. Copies of the Rights Agreement and the Certificate of Designation are available free of charge from the Company by contacting the Company's Secretary. This summary description of the Rights and the Preferred Stock does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Rights Agreement and the Certificate of Designation, including the definitions therein of certain terms, which Rights Agreement and Certificate of Designation are incorporated herein by reference.

THE RIGHTS AGREEMENT

Initially, the Rights will attach to all certificates representing shares of outstanding Company Common Stock, and no separate certificates evidencing the Rights (the "Rights Certificates") will be distributed. The Rights will separate from the Company Common Stock and the "Distribution Date" will occur upon the earlier of (i) ten business days following a public announcement (the date of such announcement being the "Stock Acquisition Date") that a person or group of affiliated or associated persons has acquired or otherwise obtained beneficial ownership of 15% or more of the then

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outstanding shares of Company Common Stock (an "Acquiring Person"), or (ii) ten business days (or such later date as may be determined by action of the Board of Directors prior to such time as any person becomes an Acquiring Person) following the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 15% or more of the then outstanding shares of Company Common Stock. Until the Distribution Date, (i) the Rights

will be evidenced by Company Common Stock certificates and will be transferred with and only with such Company Common Stock certificates, (ii) new Company Common Stock certificates issued after the Record Date (also including shares distributed from Treasury) will contain a notation incorporating the Rights Agreement by reference and (iii) the surrender for transfer of any certificates representing outstanding Company Common Stock will also constitute the transfer of the Rights associated with the Company Common Stock represented by such certificates.

An "Acquiring Person" does not include (A) the Company, (B) any subsidiary of the Company, (C) any employee benefit plan maintained by the Company or any of its subsidiaries, (D) any trustee or fiduciary with respect to such employee benefit plan acting in such capacity or a trustee or fiduciary holding shares of Company Common Stock for the purpose of funding any such plan or employee benefits, (E) any person who has reported or is required to report such beneficial ownership on Schedule 13G under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), but only so long as (x) such person is eligible to report such ownership on Schedule 13(G) under the Exchange Act, (y) such person (or any other person) has not reported and is not required to report such ownership on Schedule 13(D) under the Exchange Act, and (z) such person does not beneficially own 20% or more of the shares of Company Common Stock then outstanding, (F) any person if the Board of Directors determines in good faith that such person who would otherwise be an "Acquiring Person" became such inadvertently and without any intention of changing or influencing control of the Company, and as promptly as practicable such person divested or divests itself of beneficial ownership of a sufficient number of shares of Company Common Stock so that such person would no longer beneficially own 15% or more of the then outstanding shares of Company Common Stock, and after becoming aware that such person would inadvertently be an "Acquiring Person" (but for the operation of this clause) such person does not beneficially own any additional shares, unless such person's beneficial ownership of Company Common Stock is less than 15% of the then outstanding shares of Company Common Stock, or (G) any person who becomes the beneficial owner of 15% or more of the then outstanding shares of Company Common Stock as a result of the acquisition of shares of Company Common Stock directly from the Company in one or more transactions. In addition, no person shall be deemed an "Acquiring Person" as a result of the acquisition of shares of Company Common Stock by the Company which, by reducing the number of shares of Company Common Stock outstanding, increases the proportional number of shares beneficially owned by such person; PROVIDED, HOWEVER, that if (A) a person would become an "Acquiring Person" (but for the operation of this provision) as a result of the acquisition of shares of Company Common Stock by the Company and (B) after such share acquisition by the Company, such person becomes the

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beneficial owner of any additional shares of Company Common Stock, then such person shall be deemed an "Acquiring Person."

The Rights are not exercisable until the Distribution Date and will expire at the close of business on the tenth anniversary of the Rights Agreement unless earlier redeemed or exchanged by the Company as described below. Under certain circumstances the exercisability of the Rights may be suspended. In no event, however, will the Rights be exercisable prior to the expiration of the period in which the Rights may be redeemed.

As soon as practicable after the Distribution Date, Rights Certificates will be mailed to holders of record of Company Common Stock as of the close of business on the Distribution Date and, thereafter, the separate Rights Certificates alone will represent the Rights.

In the event that a person becomes an Acquiring Person, then, in such case, each holder of a Right will thereafter have the right to receive, upon exercise, Units of Preferred Stock or, at the option of the Board of Directors, shares of Company Common Stock (or, in certain circumstances, Company Common Stock, cash, property or other securities of the Company) having a value equal to two times the exercise price of the Right. The exercise price is the purchase price multiplied by the number of Units of Preferred Stock issuable upon exercise of a Right prior to the event described in this paragraph. Notwithstanding any of the foregoing, following the occurrence of the event set forth in this paragraph, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person will be null and void.

In the event that, at any time following the date that any person becomes an Acquiring Person, (i) the Company is acquired in a merger or other business combination transaction and the Company is not the surviving corporation, (ii) any person merges with the Company and all or part of the Company Common Stock is converted or exchanged for securities, cash or property of the Company or any other person or (iii) 50% or more of the Company's assets or earning power are sold or transferred, each holder of a Right (except Rights which previously have been voided as described above) shall thereafter have the right to receive, upon exercise, common stock of the Acquiring Person having a value equal to two times the exercise price of the Right.

The purchase price payable, and the number of Units of Preferred Stock issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Stock, (ii) if holders of the Preferred Stock are granted certain rights or warrants to subscribe for Preferred Stock or convertible securities at less than the current market price of the Preferred Stock, or (iii) upon the distribution to the holders of the Preferred Stock of evidences of indebtedness, cash or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above).

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With certain exceptions, no adjustment in the purchase price will be required until cumulative adjustments amount to at least 1% of the purchase price. The Company is not required to issue fractional shares of Preferred Stock (other than fractions which are integral multiples of one one-thousandth of a share of Preferred Stock which may be evidenced by depositary receipts). In lieu thereof, an adjustment in cash may be made based on the current market price of a share of Preferred Stock on the day of exercise.

At any time until ten business days following the Stock Acquisition Date, a majority of the Board of Directors may redeem the Rights in whole, but not in part, at a price of \$.01 per Right (subject to adjustment in certain events) (the "Redemption Price") payable, at the election of the majority of the Board of Directors, in cash or shares of Company Common Stock. Immediately upon the action of a majority of the Board of Directors ordering the redemption of the Rights, the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price.

The Company may at any time after there is an Acquiring Person, by action of a majority of the Board of Directors, exchange all or part of the then outstanding and exercisable Rights (other than Rights that shall have become null and void) for Units of Preferred Stock or shares of Company Common Stock pursuant to a one-for-one exchange ratio, as adjusted.

Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends. While the distribution of the Rights will not be taxable to stockholders or to the Company, stockholders may, depending upon the circumstances, recognize taxable income in the event that the Rights become exercisable for Units of Preferred Stock (or other consideration).

Any of the provisions of the Rights Agreement may be amended without the approval of the holders of Company Common Stock at any time prior to the Distribution Date. After the Distribution Date, the provisions of the Rights Agreement may be amended in order to cure any ambiguity, defect or inconsistency, to make changes which do not adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person), or to shorten or lengthen any time period under the Rights Agreement; PROVIDED, HOWEVER, that no amendment to adjust (i) the time period governing redemption shall be made at such time as the Rights are not redeemable or (ii) any other time period unless such lengthening is for the purpose of protecting, enhancing or clarifying the Rights of and/or benefiting, the holders of Rights. In addition, after a person becomes an Acquiring Person, no amendment or supplement may be made without the approval of a majority of the Board of Directors.

DESCRIPTION OF PREFERRED STOCK

The Units of Preferred Stock that may be acquired upon exercise of the Rights will be nonredeemable and subordinate to any other shares of preferred

stock that may be issued by the Company.

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Each Unit of Preferred Stock will have a minimum preferential quarterly dividend of \$.01 per Unit or any higher per share dividend declared on the Company Common Stock.

In the event of liquidation, the holder of a Unit of Preferred Stock will receive a preferred liquidation payment equal to the greater of \$.01 per Unit and the per share amount paid in respect of a share of the Company Common Stock.

Each Unit of Preferred Stock will have one vote, voting together with the Company Common Stock.

In the event of any merger, consolidation or other transaction in which shares of Company Common Stock are exchanged, each Unit of Preferred Stock will be entitled to receive the per share amount paid in respect of each share of Company Common Stock.

The rights of holders of the Preferred Stock with respect to dividends, liquidation and voting, and in the event of mergers and consolidations, are protected by customary antidilution provisions.

Because of the nature of the Preferred Stock's dividend, liquidation and voting rights, the economic value of one Unit of Preferred Stock that may be acquired upon the exercise of each Right should approximate the economic value of one share of Company Common Stock.

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EXHIBIT C

CERTIFICATE OF DETERMINATION OF PREFERENCES
of
SERIES A PREFERRED STOCK
of
DSP GROUP, INC.

(Pursuant to Section 151 of the General Corporation Law of the State of
Delaware)

The undersigned officers of DSP Group, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation"), in accordance with the provisions of Section 103 thereof, DO HEREBY CERTIFY:

That, pursuant to the authority conferred upon the Board of Directors of the Corporation by its Restated Certificate of Incorporation (the "Certificate"), the said Board of Directors, at a duly called meeting held on January 29, 1997, at which a quorum was present and acted throughout, adopted the following resolution, which resolution remains in full force and effect on the date hereof creating a series of 200,000 shares of Preferred Stock having a par value of \$.001 per share, designated as Series A Preferred Stock (the "Series A Preferred Stock") out of the class of 5,000,000 shares of preferred stock of the par value of \$.001 per share (the "Preferred Stock"):

RESOLVED, that pursuant to the authority vested in the Board of Directors in accordance with the provisions of its Certificate, the Board of Directors does hereby create, authorize and provide for 200,000 shares of its authorized Preferred Stock to be designated and issued as the Series A Preferred Stock, having the voting powers, designation, relative, participating, optional and other special rights, preferences and qualifications, limitations and restrictions that are set forth as follows:

Section 1. DESIGNATION AND AMOUNT. Two Hundred Thousand (200,000) shares of Preferred Stock, \$.001 par value per share, are designated "Series A

Preferred Stock" with the rights, preferences, privileges and restrictions specified herein (the "Series A Preferred Stock"). Such number of shares may be increased or decreased by resolution of the Board of Directors; PROVIDED, that no decrease shall reduce the number of shares of Series A Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Preferred Stock.

Section 2. DIVIDENDS AND DISTRIBUTIONS.

(A) Subject to the prior and superior rights of the holders of any shares of any other series of Preferred Stock or any other shares of stock of the Corporation ranking prior and

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superior to the shares of Series A Preferred Stock with respect to dividends, each holder of one one-thousandth (1/1000) of a share (a "Unit") of Series A Preferred Stock shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for that purpose, (i) quarterly dividends payable in cash on the last day of February, May, August and November in each year (each such date being a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the first issuance of such Unit of Series A Preferred Stock, in an amount per Unit (rounded to the nearest cent) equal to the greater of (a) \$.01 or (b) subject to the provision for adjustment hereinafter set forth, the aggregate per share amount of all cash dividends declared on shares of the Common Stock since the immediately preceding Quarterly Dividend Payment Date, or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of a Unit of Series A Preferred Stock, and (ii) subject to the provision for adjustment hereinafter set forth, quarterly distributions (payable in kind) on each Quarterly Dividend Payment Date in an amount per Unit equal to the aggregate per share amount of all non-cash dividends or other distributions (other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock, by reclassification or otherwise) declared on shares of Common Stock since the immediately preceding Quarterly Dividend Payment Date, or with respect to the first Quarterly Dividend Payment Date, since the first issuance of a Unit of Series A Preferred Stock. In the event that the Corporation shall at any time after June 5, 1997 (the "Rights Declaration Date") (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock or (iii) combine outstanding shares of Common Stock into a smaller number of shares, then in each such case the amount to which the holder of a Unit of Series A Preferred Stock was entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which shall be the number of shares of Common Stock that are outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) The Corporation shall declare a dividend or distribution on Units of Series A Preferred Stock as provided in paragraph (A) above immediately after it declares a dividend or distribution on the shares of Common Stock (other than a dividend payable in shares of Common Stock); PROVIDED, HOWEVER, that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of \$.01 per Unit on the Series A Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(C) Dividends shall begin to accrue and shall be cumulative on each outstanding Unit of Series A Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issuance of such Unit of Series A Preferred Stock, unless the date of issuance of such Unit is prior to the record date for the first Quarterly Dividend Payment Date, in which case, dividends on such Unit shall begin to accrue from the date of issuance of such Unit, or unless the date of issuance is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of Units of Series A Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date.

Accrued but unpaid dividends shall not bear interest. Dividends paid on Units of Series A Preferred Stock in an amount less than the aggregate amount of all such dividends at the time accrued and payable on such Units shall be allocated pro rata on a unit-by-unit basis among all Units of Series A Preferred Stock at the time outstanding. The Board of Directors may fix a record date for the determination of holders of Units of Series A Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be no more than 30 days prior to the date fixed for the payment thereof.

Section 3. VOTING RIGHTS. The holders of Units of Series A Preferred Stock shall have the following voting rights:

(A) Subject to the provision for adjustment hereinafter set forth, each Unit of Series A Preferred Stock shall entitle the holder thereof to one vote on all matters submitted to a vote of the stockholders of the Corporation. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the number of votes per Unit to which holders of Units of Series A Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction the numerator of which shall be the number of shares of Common Stock outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event; and

(B) Except as otherwise provided herein, in the Certificate or the Bylaws of the Corporation or as required by law, the holders of Units of Series A Preferred Stock and the holders of shares of Common Stock shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation, and such holders shall have no special voting rights and their consents shall not be required for taking any corporate action.

Section 4. CERTAIN RESTRICTIONS.

(A) Whenever quarterly dividends or other dividends or distributions payable on Units of Series A Preferred Stock as provided herein are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on outstanding Units of Series A Preferred Stock shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends on, make any other distributions on, or redeem or purchase or otherwise acquire for consideration any shares of junior stock;

(ii) declare or pay dividends on or make any other distributions on any shares of parity stock, except dividends paid ratably on Units of Series A Preferred Stock and shares of all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of such Units and all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any parity stock, PROVIDED, HOWEVER, that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such parity stock in exchange for shares of any junior stock; or

(iv) purchase or otherwise acquire for consideration any Units of Series A Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such Units.

(B) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in

such manner.

Section 5. REACQUIRED SHARES. Any Units of Series A Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such Units shall, upon their cancellation, become authorized but unissued shares (or fractions of shares) of Preferred Stock and may be reissued as part of a new series of Preferred Stock to be created by resolution or resolutions of the Board of Directors, subject to the conditions and restrictions on issuance set forth herein.

Section 6. LIQUIDATION, DISSOLUTION OR WINDING UP.

(A) Upon any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, no distribution shall be made (i) to the holders of shares of junior stock unless the holders of Units of Series A Preferred Stock shall have received, subject to adjustment as hereinafter provided in paragraph (B), the greater of either (a) \$.01 per Unit plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not earned or declared, to the date of such payment, or (b) the amount equal to the aggregate per share amount to be distributed to holders of shares of Common Stock, or (ii) to the holders of shares of parity stock, unless simultaneously therewith distributions are made ratably on Units of Series A Preferred Stock and all other shares of such parity stock in proportion to the total amounts to which the holders of Units of Series A Preferred Stock are entitled under clause (i)(a) of this sentence and to which the holders of shares of such parity stock are entitled, in each case upon such liquidation, dissolution or winding up.

(B) In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock, or (iii) combine outstanding shares of Common Stock into a smaller number of shares, then in each such case the aggregate amount to which holders of Units of Series A Preferred Stock were entitled immediately prior to such event pursuant to clause (i)(b) of paragraph (A) of this Section 6 shall be adjusted by multiplying such amount by a fraction the numerator of which shall be the number of shares of Common Stock that are outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

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Section 7. CONSOLIDATION, MERGER, ETC. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or converted into other stock or securities, cash and/or any other property, then in any such case Units of Series A Preferred Stock shall at the same time be similarly exchanged for or converted into an amount per Unit (subject to the provision for adjustment hereinafter set forth) equal to the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is converted or exchanged. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock, or (iii) combine outstanding Common Stock into a smaller number of shares, then in each such case the amount set forth in the immediately preceding sentence with respect to the exchange or conversion of Units of Series A Preferred Stock shall be adjusted by multiplying such amount by a fraction the numerator of which shall be the number of shares of Common Stock that are outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 8. REDEMPTION. The Units of Series A Preferred Stock and shares of Series A Preferred Stock shall not be redeemable.

Section 9. RANKING. The Units of Series A Preferred Stock and shares of Series A Preferred Stock shall rank junior to all other series of the Preferred Stock and to any other class of Preferred Stock that hereafter may be issued by the Corporation as to the payment of dividends and the distribution of assets, unless the terms of any such series or class shall provide otherwise.

Section 10. FRACTIONAL SHARES. The Series A Preferred Stock may be issued in Units or other fractions of a share, which Units or fractions shall entitle

the holder, in proportion to such holder's units or fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Preferred Stock.

Section 11. CERTAIN DEFINITIONS. As used in this resolution with respect to the Series A Preferred Stock, the following terms shall have the following meanings:

(A) The term "Common Stock" shall mean the class of stock designated as the common stock, par value \$.001 per share, of the Corporation at the date hereof or any other class of stock resulting from successive changes or reclassification of the common stock.

(B) The term "junior stock" (i) as used in Section 4 shall mean the Common Stock and any other class or series of capital stock of the Corporation hereafter authorized or issued over which the Series A Preferred Stock has preference or priority as to the payment of dividends and (ii) as used in Section 6, shall mean the Common Stock and any other class or series of capital stock of the Corporation over which the Series A Preferred Stock has preference or priority in the distribution of assets on any liquidation, dissolution or winding up of the Corporation.

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(C) The term "parity stock" (i) as used in Section 4 shall mean any class or series of stock of the Corporation hereafter authorized or issued ranking PARI PASSU with the Series A Preferred Stock as to dividends and (ii) as used in Section 6, shall mean any class or series of capital stock ranking PARI PASSU with the Series A Preferred Stock in the distribution of assets on any liquidation, dissolution or winding up.

IN WITNESS WHEREOF, the undersigned have executed this certificate on this _____ day of June, 1997.

DSP GROUP, INC.

By:

Eliyahu Ayalon
President and Chief Executive Officer

By:

Avi Basher
Vice President of Finance,
Chief Financial Officer and Secretary

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OFFICER'S CERTIFICATE

MARCH 30, 1999

The undersigned, Avi Basher, hereby certifies as follows:

(a) I am the duly elected, qualified, acting and incumbent Vice President of Finance, Chief Financial Officer and Secretary of DSP Group, Inc. (the "Company").

(b) Attached hereto is an English translation of a Lease Contract, dated as of September 13, 1998, by and between Bayside Land Corporation Ltd. and DSP Semiconductors, Ltd.

(c) To my knowledge, such translation is a fair and accurate translation as required under Rule 306 of Regulation S-T promulgated by the Securities and Exchange Commission.

IN WITNESS WHEREOF, the undersigned has duly executed this Certificate on behalf of the Company as of the date first written above.

DSP GROUP, INC.

/s/ Avi Basher

Avi Basher, Vice President of Finance,
Chief Financial Officer and Secretary

LEASE AGREEMENT

DRAWN UP AND SIGNED IN HAIFA ON SEPTEMBER 13TH 1998

BETWEEN

BAYSIDE LAND CORPORATION LTD.

Of 24 Haprasim St., Haifa

(hereinafter: "The Lessor")

AND

DSP GROUP LTD.

Company No. 51-135472-2

Of 5 Shenkar St., Herzlia Pituach

(hereinafter: "The Lessee")

WHEREAS, the Lessor is the holder of lease rights in a real-estate property, known as Parcels 57 and 73 in Block 6592 (hereinafter: "The Plot"), located on Shenkar Street in Herzlia Pituach, all as appearing on the map and in the Land Extract, enclosed with this Contract, as Appendices A and C;

AND WHEREAS, the Lessor, inter alia, erects several constructions on the Plot, which would be referred to as the Bayside (Gav Yam) Center, among them, the Lessor constructs, as per a construction permit that was lawfully issued, a construction on a gross area of approx. 22,500 sq. mtrs., known as Construction No. 2 (hereinafter: "The Construction") and which is intended for lease, all as appearing on the map, Appendix A, and in the Technical Specification, Appendix D;

AND WHEREAS, the Lessor prepared a detailed planning of the Construction (hereinafter: "The Planning");

AND WHEREAS, the Lessee declares and approves, that the aforementioned Planning is appropriate for its requirements and it is interested in leasing part of the Construction in an inclusive area of approx. 590 sq. mtrs. for the purpose stated in this Contract;

AND WHEREAS, the Lessor declares, that it agrees to lease part of the Construction to the Lessee in accordance with that stated in this Contract;

Therefore, it has been declared and agreed between the parties, as follows:

1. GENERAL

1.1 The preamble to this Contract constitutes an integral part thereof.

1.2 This Lease Contract includes a map - Appendix A, plans of the leased - Appendix B, Land Extract - Appendix C, Technical Specification - Appendix D, Insurance Appendix - Appendix E, the Parking Lot Contract - Appendix G, the Electricity Appendix - Appendix H, Bank Guarantee Appendix, Appendix I.

In order to remove any doubt, it is hereby clarified that in any event of discrepancy between the provisions of this Contract and the provisions of the Appendices, the provisions which are less favorable to the Lessee shall supersede.

1.3 Wherever an amount in Dollars is mentioned in this Contract it is only made for purposes of convenience and it lacks any legal validity, for the amounts indicated in Dollars shall be translated to the Shekel upon the signing of the Agreement, in accordance with the representative rate of the Dollar, known upon the signing of the Contract, i.e. 3.80 Shekel per United States Dollar.

2. HEADINGS

The headings of the Sections were inserted for purposes of ease of reading alone and should not be used for their interpretation.

3. INTERPRETATION

Without prejudice to other definitions, specified in this Contract, the following terms shall be interpreted in accordance with that stated alongside them, as follows:

3.1 "The Leased" - part of the Construction in an area of approx. 590 sq. mtrs. on the first story - +6.00 of the Construction, including the equipment and the fixtures installed therein, all as marked yellow in Appendix B.

In order to remove any doubt, The area leased as specified above also includes a relative part of the entrance lobby to the joint construction for all the office stories of the Construction and also story's public areas, all in an inclusive area of approx. 94 sq. mtrs.

3.2 "Delivery" - placing the Leased at the possession of the Lessee, as it is in a reasonable usable condition for the purposes of the Lessee, all in accordance with the conditions of the Contract.

3.3 "The Inspector" - Mr. Menasha Friedman or any person from another inspecting office, replacing him, all in accordance with the determination of the Lessor.

4. THE LEASE AND THE PERIOD OF THE LEASE

4.1 4.1.1 Subject to that stated herebelow, the Lessor leases to the Lessee and the Lessee leases the Leased from the Lessor for the objectives of the lease, as stated in Section 7 herebelow, for a five year period and according to the other conditions of this Contract.

4.1.2 Without prejudice to that stated above, the Lessee shall have an option to extend the lease period for an additional five year period (hereinafter: "The Option Period") so long as it would pass an early notice in writing to the Lessor, at least nine months prior to the completion of the lease period.

4.2 The lease period shall commence upon the delivery date of the Leased to the Lessee, i.e. December 1st 1998 (hereinafter: "The Delivery Date") so long as the Lessee fulfilled all its obligations in accordance with this Contract.

4.3 The parties agree, that in one or more of the events, specified herebelow, the Delivery Date shall be extended and such a delay shall not be regarded as breach of this Agreement.

4.3.1 In the event of a delay with the delivery of the Leased and/or placing the Leased in the possession of the Lessee, as specified in Section 5 herebelow, in consequence of a force majeure and also in consequence of actions and/or instructions and/or orders and/or omissions of competent authorities, which are not as a result of the conduct of the Lessor and/or general strikes in the construction sector, including all its sub-sectors and also due to any cause and/or circumstances which are not in control of the Lessor.

4.3.2 In the event of a delay with the delivery of the Leased to the Lessee, caused as a result of changes made in the Leased according to the requirement of the Lessee and/or work made in the Leased by the Lessee and/or anyone on its behalf, but excluding finish works, according to their definition in Section 6.2 herebelow.

4.3.3 The parties agree, that the Inspector shall have the singular and exclusive authority to determine whether the conditions stated in Sub-Sections 4.3.1 and 4.3.2 above are met and also what is the extension of the Delivery Date in consequence thereof. The determinations of the Inspector shall be final decisive and obligatory.

5. RECEIPT OF THE LEASED

5.1 The Lessee hereby declares, that it has examined and approved the plans of the Leased, Appendix B, and the Technical Specification, Appendix

B, and it found them to be appropriate and suitable for the purpose of the lease, as per this Contract, and it is obligated to receive possession of the Leased upon the Delivery Date, on condition that the Inspector issued the approval, stated herebelow.

The Lessor is hereby obligated, that upon the Delivery Date the finish works will be completed, as stated in Section 6.2 herebelow, the central systems of sewage, air-conditioning and lifts shall be operating in the Construction, and also that the Leased will receive regular supply of electricity, water and telephone feed infrastructure at end points, according to the Technical Specification and the specifications of the finish works (hereinafter: "The Systems"). Upon the Delivery Date of possession of the Leased to the Lessee, as stated above, a visit to the Leased shall be carried out in the presence of the representative of the Lessor, the representative of the Lessee and the Inspector, in the framework of which the Inspector shall approve, that the Leased was built in accordance with the plans and the Technical Specification, and a technical protocol, specifying the required works for performance and the repairs, if any, shall be prepared. The technical protocol shall be signed by the representatives of the Lessor and the Lessee and it shall serve as a preponderant evidence with regard to the condition of the Leased upon the Delivery Date.

5.2 In any event, the determination of the Inspector, that the Leased is ready for delivery in accordance with the conditions of the Contract and its Appendices, shall be final, absolute and obligating for the purpose of this Agreement.

5.3 In order to remove any doubt, the Lessee hereby declares that it was informed that upon the Delivery Date of the Leased, the Lessor shall

still be working on the performance of the finish works in the Construction and/or in other leaseds of other lessees in the Construction and the Lessee shall not

have any contention and/or claim toward the Lessor in this respect, so long as there will not be interference with the reasonable use of the Leased by the Lessee.

6. THE LEASED - TECHNICAL DESCRIPTION AND CHANGES, FINISH WORKS, COMPLETIONS AND SUPPLEMENTS

6.1 The Leased and the Construction, including all their elements, shall be built and completed in accordance with the plans, Appendix B, and the Technical Specification, Appendix D, including the changes made in it in accordance with the discretion of the Lessor, with the exception of essential changes, as per the final and absolute decision of the Inspector, made in the agreement of the Lessee. Deviation in a rate of up to 2% between the planning and the actual condition shall not be regarded as an essential change. The Leased, including all its elements, shall be built of good materials by means of a professional manpower.

6.2 In light of the request of the Lessee, that the Lessor shall carry out the finish works in the Leased (hereinafter: "The Finish Works") prior to the Delivery Date to the Lessee, it was agreed between the parties as follows:

6.2.1 Until September 18th 1998, the Lessee shall pass to the Lessor all the technical material, required for the issuance of a tender pursuant to the performance of the Finish Works, which would be approved in advance by the Lessor, including the technical specifications, the work plans and letters of quantities.

6.2.2 The planning of the Finish Works shall be carried out by the Architect Ilan Eldar for the Lessee, as his fee is paid by the Lessor. Architect Eldar will be entitled to hire additional consultants pursuant to the performance of his work. The identity of the consultants shall be approved by the Lessor and their fee shall be paid by it.

6.2.3 The planning of the Finish Works shall be made in coordination with the Lessor and will require the approval of the Lessor.

6.2.4 In addition to the cost of the Finish Works, the Lessee will pay to the Lessor 5% of the cost of the Finish Works, management moneys and also 3% of the fee of the Inspector.

6.2.5 The Lessor shall issue a tender for the receipt of proposals for the performance of the Finish Works, as a single set, and the winner of the tender shall be chosen by a joint tender committee of the Lessor and the Lessee, consisting of one representative of each party.

6.2.6 The Lessor shall commit in a contract with the winner of the tender (hereinafter: "The Finish Works Contractor").

6.2.7 The Lessee is obligated to pay to the Lessor each and every invoice, that the Lessor shall approve for payment to the Finish Works Contractor, that being upon the payment date of the invoice to the Finish Works Contractor, no payment shall be made without such deviation being approved in advance by the Lessee.

6.2.8 For the assurance of the payments to the Finish Works Contractor, as stated in Section 6.2.7 above, the Lessee shall furnish the Lessor with an index linked financial bank guarantee, according to 25% of the amount of the proposal of the Finish Works Contractor.

6.2.9 In order to remove any doubt, the Lessee is obligated to pay to the Lessor all the costs of the performance of the Finish Works, including work and materials, whether they are paid by the Lessor to the Finish Works Contractor or paid directly by him to any other organization, so long as any deviation from the conditions of the original proposal of the Finish Works Contractor shall require the early approval of the Lessee.

6.2.10 The Lessor shall be liable towards the Lessor in all matters pertaining to the quality of the performance of the Finish Works, that being for a one year period from the Delivery Date, and the provisions of Section

5.1 with respect to the delivery of the Leased shall apply to the delivery of the Finish Works.

6.2.11 In any event of a delay with the performance of the Finish Works, caused in consequence of an action or an omission of the Lessee or anyone on its behalf, including a delay with the performance of the planning and including a delay in the delivery of documents, as stated in Section 6.2.1 above - it will not effect the date of receipt of the Leased, the Delivery Date, and the obligation of the Lessee to pay the lease moneys to the Lessor as from the Delivery Date, according to its definition in Section 4.2 above.

6.3 The parties further agree, that any supplement or addition made in the Leased at the expense of the Lessee will become the property of the Lessor, that being to the extent that the addition or the change corresponds with the definition of fixtures, according to their definition in the Land Law, 5729 - 1969. In the event, that the change or the supplement does not correspond with the definition of fixtures it will be regarded as the property of the Lessee and the Lessee will be entitled to remove and/or disassemble it upon the completion of the lease period, so long as the Leased is returned in good condition worthy for immediate leasing.

In order to remove any doubt, the provisions of this Section shall not apply to movable partitions or to movable furniture. In order to remove any doubt, in any event where the Lessee chooses not to remove and/or disassemble the supplement or the change, which does not correspond with the definition of a fixture, the Lessee will not be entitled to require and receive from the Lessor any consideration for it.

6.4 The Lessee hereby declares, that it has been brought to its knowledge, that additional constructions, adjacent and nearby the Construction, will be built by the Lessor and/or anyone on its behalf, and it

hereby relinquishes any contention and/or claim toward the Lessor in this matter or anything deriving therefrom.

Furthermore, the Lessor is hereby obligated that the construction of the additional constructions, as stated above, shall not interfere with the access to the Leased, and that the aforementioned construction work shall be carried out in such a manner as to allow reasonable use of the Leased.

7. PURPOSE OF THE LEASE

The purpose of the lease is for the planning and development of Hi-Tech products and also for management activity, laboratories and marketing in the field of computers alone, and the Lessee is obligated to use the Leased solely for this purpose (hereinafter: "The Purpose of the Lease").

8. LEASE MONEYS

8.1 8.1.1 For offices - NIS 31,388 per month (an amount in Shekel equivalent to US \$8,260 per month) (hereinafter: "The Basic Lease Moneys").

8.1.2 For parking places - as specified in Section 14a herebelow and in the Parking Lot Management Contract, Appendix G.

8.1.3 Maintenance moneys for the Leased - as stated in Section 20 herebelow.

8.1.4 Payments for electricity, as specified in the Electricity Appendix, Appendix H.

8.2 As from June 1st 2002, the Lease Moneys shall include a real addition of 6% on the Lease Moneys, payable upon the commencement date of

the option had it not been for the aforementioned addition. All the other provisions of this Contract, including the provisions of this Section 8, shall apply accordingly to the Lease Moneys during the Option Period.

8.3 The Basic Lease Moneys shall include the addition of index linkage differences, as specified in Section 11 herebelow.

The index, that was published on August 15th 1998 (156.3 points) is determined as the basic index for the purpose of this Contract (hereinafter: "The Basic Index").

8.4 The Lessee is obligated to pay to the Lessor the Basic Lease Moneys together with linkage differences, accrued on them, and together with VAT for the entire lease period, as follows:

8.4.1 The Lease Moneys for the first three months of the lease in the amount of NIS 94,164 (an amount in NIS equivalent to US \$24,780) will be paid by the Lessee to the Lessor in the stand of signing this Contract.

The remaining Lease Moneys will be paid according to three - month payments for each period in advance, that being on the first day of each and every three month period.

8.4.2 Payments of the Lease Moneys, as stated above, shall be paid by way of a bank transfer from the account of the Lessee to the account of the Lessor.

8.4.3 Payment of the Lease Moneys shall be updated, as specified in Section 11.

8.4.4 The Lessee hereby waives the requirement, if any, for the giving of an early notice or requirement for the payment of the Lease Moneys.

9. SHAREHOLDERS

9.1 The Lessee hereby declares, that the DSP Group Inc. (hereinafter: "DSP Group") is the shareholder in control of it.

9.2 The Lessee is hereby obligated to bring about, that its shareholder in control, DSP Group, at the stand of signing this Contract, shall guarantee to

all the obligations of the Lessee toward the Lessor in accordance with the conditions of this Contract, including all its Appendices.

9.3 The Lessee is obligated, that during the lease period no changes, whether directly or indirectly, shall be made in the holding of the shares by DSP Group in such a manner, that the holding of the shares of DSP Group in the Lessee shall decrease below 51%, unless the early explicit approval in writing of the Lessor was given to that effect.

Notwithstanding that stated above, it is agreed, that the Lessee shall not require the agreement of the Lessor for a change of holdings as stated, should it furnish the Lessor with a bank guarantee according to a sufficient amount to the satisfaction of the Lessor.

10. INAPPLICABILITY OF THE TENANT'S PROTECTION LAW

10.1 The Lessee hereby declares and approves as follows:

10.1.1 The protection of tenants in accordance with the Tenant's Protection Law (Combined Version), 5752 - 1972, or according to any other Law, shall not apply to this lease.

10.1.2 The Lessor did not receive any payment of key moneys or any other consideration whatsoever, whether directly or indirectly, in connection with this lease.

10.1.3 Upon the commencement of this lease, there was no tenant in the Leased, being lawfully entitled to hold it.

The Lessee hereby declares and approves, that its expenses and investments in the preparation of the changes in the Leased, the additions and/or renovations and/or participation in expenses or in any other investment pursuant to the adjustment of the Leased to its purposes shall in no way be regarded as key moneys of any kind whatsoever and shall not confer the Lessee any right whatsoever, and these investments shall not alter that stated above in

accordance with which the leased is not under any of the tenant's protection laws.

11. LINKAGE

11.1 For the purpose of this Lease Contract:

Index - The Consumer Price Index (including fruits and vegetables) published by the Central Bureau of Statistics, including same index if it is published by another governmental organization and also any official index replacing it, whether such index is based on same data as the index prevailing upon the signing of this Agreement or not. In the event, that there will be another index, the ratio between the indexes shall be according to the determination of the Central Bureau of Statistics or according to another official organization replacing the Central Bureau of Statistics.

In the event, that the ratio between the indexes is not determined, as stated above, the ratio shall be determined by the economical department of Bank Leumi of Israel Ltd. (at the expense of the Lessee and the Lessor in equal parts).

11.2 The Basic Lease Moneys and all the amounts indicated in Shekels in this Agreement shall be linked to the increase of the index, according to its definition above. In the event, that upon the payment date of any part of the Lease Moneys (hereinafter: "The Determining Date") the index recently published prior to the Determining Date (hereinafter: "The New Index") is higher in comparison to the Basic Index, the Lessee is obligated to pay to the Lessor same payments of Basic Lease Moneys, as they are relatively increased, as per the increase of the New Index in comparison to the Basic Index.

The aforementioned calculated additions above the Basic Lease Moneys shall be referred to in this Contract, as "Linkage Differences".

11.3 For the purpose of the calculation of the increase in the index, the payment date shall be regarded as the date in which the Lease Moneys were actually paid. However, it is hereby emphasized, that this shall not be viewed as a waiver or agreement on behalf of the Lessor with respect to the obligation of the Lessee to pay the Lease Moneys upon the agreed dates nor shall it be viewed as any waiver of the relieves to which the Lessor is entitled in case of failure to pay in due time.

11.4 The Lessee is hereby obligated to pay the Linkage Differences immediately upon the first requirement of the Lessor.

11.5 The Linkage Differences shall be regarded as Lease Moneys for each and every purpose.

11.6 The Lessee has the right to pay the Lease Moneys for any part of the lease period in advance and in such a case linkage on same amount shall apply up until its actual payment.

12. ADJUSTMENT, USE, RECEIPT OF PERMITS AND ABIDANCE BY LAWS

12.1 The Lessee is obligated to use the leased solely for the purpose of the lease, stated in Section 7 above, and not for any other purpose whatsoever.

12.2 The Lessee hereby declares, that it had the possibility of viewing and examining the planning condition of the Leased and the Development and/or Lease Agreement and/or the Urban Construction Plan applying to it

and that the zoning {designation} of the Leased in accordance with that stated above, and it is aware that any payment of any kind whatsoever, applying to the Leased for the specific use of the Lessee - shall apply to the Lessee.

12.3 The Lessee is hereby obligated to obtain all the permits required by Law pursuant to the use of the Leased or any part thereof, for the management of its enterprise in the Leased and to act according to them.

12.4 In order to remove any doubt, the Lessee hereby declares, that it shall not have any contentions toward the Lessor with regard to the possibilities to use the Leased, and that it is aware that the Lessor shall not bear any liability whatsoever for the receipt of whatever permits, required for the management of the enterprise of the Lessee in the Leased or for the adjustment of the Leased in accordance with the instructions of any competent authority in connection with the giving of a permit, as above.

That stated above shall not derogate from the basic obligation of the Lessor to build and to complete the Leased in accordance with a lawful construction permit and to meet all the provisions of the Law with respect to the completion of the Leased and its populating.

12.5 The Lessee is obligated to abide by any Law and to act in accordance with the provisions of any permit, applying to the Leased and/or any part thereof and to avoid any action or omission, that may impose any liability whatsoever on the Lessor toward any person or property.

12.6 The Lessor hereby declares, that it is entitled to lease the Leased according to the objective of the lease, as defined in this Agreement, and that there is no impediment in accordance with any Law, agreement or any prior obligation, preventing the Lessor from leasing the Leased to the Lessee.

13. TRANSFER OF RIGHTS

13.1 The Lessee is obligated not to deliver and/or transfer and/or lease and/or assign and/or endorse and/or mortgage its rights in accordance with this Contract in any way or manner whatsoever, and also not to allow any

third party to use and/or to hold the Leased or any part thereof, and it should also avoid participating any third party in the possession of the Leased or the use thereof or in any benefit thereof in any manner whatsoever, not even as an authorized or as a franchiser, whether directly or indirectly, in consideration or without consideration, unless it receives the early and explicit approval in writing of the Lessor.

13.2 Notwithstanding that stated above, the Lessee is entitled to sublet the Leased, so long as the following conditions are met:

13.2.1 The Lessor gave its early consent in writing with respect to the sub - lessee.

In order to remove any doubt, the parties agree, that the Lessor shall not deny its consent but only due to reasonable causes. Furthermore, the parties agree, that a sublet to subsidiaries, affiliated companies of the Lessee or of the parent company of the Lessee shall not require the approval of the Lessor, and the provisions of Sections 13.2.2 and 13.2.4 shall apply instead of the provisions of Section 13.2.3 herebelow.

13.2.2 The Contract with the sub - lessee shall be according to the draft of this Lease Contract, mutatis mutandis, including all its Appendices, and according to schedules not exceeding the schedules stated in this contract and without giving the sub - lessee any preferred right exceeding the rights of the Lessee in accordance with this Contract.

13.2.3 The Lessor will be entitled in accordance with its exclusive discretion to commit directly with such a sub - lessee concurrently with the canceling of the Contract with the Lessee.

13.2.4 The Lease Contract with the sub - lessee will be for the

purpose of the operation of an enterprise and/or business, engaging with know-how based industries.

13.3 Without prejudice to the generality of that stated in Section 13.2 above, it is agreed that in the event of a sublet, as stated above, the Lessee shall still be liable toward the Lessor for the fulfillment of all its obligations and/or the obligations of the sub - lessee in accordance with this Contract and/or the Sublet Contract.

13.4 The Lessor is entitled to deliver and/or transfer and/or endorse and/or pledge and/or mortgage all its rights and/or obligations in the Leased, as per this Contract, in any manner or way whatsoever, without any restriction and without having to receive the agreement of the Lessee, so long as the rights of the Lessee in accordance with this Agreement are not prejudiced .

13.5 The Lessee is obligated, that in any event in which it is required to sign any document or note, which is required pursuant to the transferring of the rights of the Lessor to any third party, it will sign each and every document or note, as stated, immediately upon receipt of the requirement of the Lessor, so long as a signature, as stated, will not impose any additional charge on the Lessee, above the charges applying to it in accordance with the provisions of this Contract.

14. CHANGES IN THE LEASED - AFTER DELIVERY OF THE LEASED TO THE LESSEE

The parties agree, that in any event where the Lessee seeks to make changes in the Leased after the Delivery Date, the following provisions shall apply:

14.1 The Lessee is obligated to avoid the carrying out or allowing another to carry out any internal and/or external changes in the Leased and to avoid the performance of any addition or destroying any part of the Leased and/or any of its facilities nor to allow the making of any changes and/or additions and/or such demolitions (hereinafter: "The Changes") without the receipt of the early agreement in writing of the Lessor.

In order to remove any doubt, it is hereby agreed and declared, that the installation of movable partitions in the Leased, including gypsum partitions and the placing of movable furniture shall not be regarded as Changes for the purpose of this Section.

In the event, that the Lessee made Changes, as stated, and the Lessor required that the condition of the Leased will be reverted, the Lessee will be obligated to revert the condition of the Leased within 14 days from the date of the requirement.

In the event, that the Lessee failed to perform its obligation, as stated, the Lessor will be entitled to carry it out by itself and/or by means of anyone on its behalf, at the expense of the Lessee together with 10% of said amount for the covering of general expenses of the Lessor, and the Lessee shall have no contention and/or requirement of any kind and type whatsoever due to the performance by the Lessor of that stated above.

14.2 In the event, that the Lessor gives its consent to the request of the Lessee pursuant to the making of Changes in the Leased, and the Changes shall include the addition of "fixtures", according to their definition in the Land Law, 5729 - 1969, the fixtures will become the property of the Lessor upon vacating the Leased, and the Lessee will not be entitled to remove them from the Leased or to revert the Leased to its condition prior to the Changes, unless the Lessor notifies the Lessee in advance and in writing with respect to its requirement, that the Leased will be reverted to its condition prior to the Changes.

In order to remove any doubt, any Change, that includes the addition of fixtures, as stated, shall not be regarded as payment of key moneys, according to their definition in the Tenant's Protection Law, 5732 - 1972, and the Lessee will not be entitled to receive any consideration from the Lessor and/or anything for them.

In the event, that the Lessee carries out Changes in the Leased, following the agreement of the Lessor, which do not correspond with the definition of "fixtures", as stated above, the Lessee will be obligated upon the completion of the lease period to revert the Leased to its previous condition, as it was prior to the making of the Changes in the Leased, unless the Lessor passes the Lessee an early notice in writing concerning its agreement for leaving the Changes in the Leased. In the event, that the Lessor notifies of its agreement for leaving the Changes in the Leased, the Lessee will not be entitled to remove them from the Leased or to make any change in them, and upon the completion of the lease period they will be transferred to the possession and proprietorship of the Lessor, without the Lessee being entitled to require and/or receive compensation or payment for it, and without it being regarded as key moneys, as stated.

14.3 The Lessor shall have the right to carry out whatever construction on the roof of the Leased, so long as the reasonable benefit of the Lessee from the Leased is not injured during the period of the construction and/or thereafter - notwithstanding that stated above.

14a. PARKING LOTS

The Lessee was informed, that the Lessor and/or anyone on its behalf shall be operating an underground parking lot in the Construction, as specified in Appendix G to the Contract, subject to the provisions of this Section as follows:

14a.1 The parties agree, that the Lessee shall have the right to lease marked parking places and entrance rights to the parking lot, according to their definition herebelow, up to an inclusive number of ____ packing places in the parking lot, that being according to the prices indicated in Sections 14a.1.1 and 14a.1.2 herebelow:

14a.1.1 In consideration of the parking places, intended for the sole use of the Lessee and/or its employees and/or guests (hereinafter: "The Marked Parking Places") an amount of NIS ____ (an amount in Shekel equivalent to US \$ _____) for each Marked Parking Place per month.

14a.1.2 For the entrance right to the parking lot on the basis of vacant places without conferring the Lessee a right for any specific place (hereinafter: "The Entrance Right to the Parking Lot") an amount of NIS ____ (an amount in Shekel equivalent to US \$ _____) for each Entrance Right to the Parking Lot per month.

14a.1.3 Out of the ____ parking places, which the Lessee is entitled to lease, the Lessee is obligated to lease from the Lessor during the lease period at least ____ Marked Parking Places and ____ Entrance Rights to the Parking Lot.

Not later than the Delivery Date, the Lessee is obligated to notify to the Lessor with regard to the number of Marked Parking Places and the number of Entrance Rights to the Parking Lot, which it seeks to lease, in addition to the ____ places mentioned above, that being out of the total parking places, that the Lessee is entitled to lease, as stated in Section 14a.1.

14a.1.4 Notwithstanding that stated above and in Appendix G, the parties agree that the Lessee will be entitled to change the number of parking places once every quarter, that being to the extent that it is possible, while taking into consideration the parking occupancy in the building at such a time.

14a.2 Instructions with regard to the dates of operation of the parking lot and the other provisions of Appendix G shall be obligating upon the Lessee for each and every matter. Without prejudice to the generality of that stated above, it is agreed that the parking lot shall be open and accessible to the Lessee between the hours 06.00 - 22.00 on Sunday through Thursday, and between 07.00 - 14.00 on Friday, with the exception of Holidays.

14a.3 The parking fee for the Marked Parking Places and for the Entrance Right to the Parking Lot shall be regarded as lease moneys for each and every purpose and shall be linked to the index, as specified in the Parking

Lot Appendix, Appendix G, and all the provisions of this Contract shall apply to them, without prejudice to any relief to which the Lessor and/or the Management Company and/or the Parking Lot Management Company are entitled in accordance with the Parking Lot Management Agreement.

14a.4 In order to remove any doubt, it is hereby clarified that in any event of a discrepancy between the provisions of this Contract and the provisions of Appendix G, those provisions which are less favoring upon the Lessee shall supercede.

15. MAINTENANCE AND PREVENTION OF NUISANCES

15.1 The Lessee shall maintain the Leased in a good and orderly condition, it shall maintain the order and cleanliness of the Leased and its surroundings, its facilities, accessories and all that is accompanying it, including service rooms located in the Leased and all the services which are intended for the sole use of the Lessee. The Lessee is obligated to make a prudent and punctual use of them and will avoid causing any damage or spoilage to the Leased or to its facilities.

Without prejudice to the generality of that stated above and below, the Lessee is obligated to maintain the good working order of all the facilities installed in the Leased, and to see to their day-to-day maintenance, including the making of repairs and replacements, to the extent required, and to return the Leased to the Lessor upon the date when the Leased is returned to the Lessor, as stated above, in a good and orderly condition, with the exception of wear and tear emerging from normal and reasonable use of the Leased.

15.2 The Lessee shall abide by the instructions of each and every competent authority, as such would be applied from time to time in connection with cleaning arrangements, manner of removal of waste residuals and maintaining the orderly condition of the drainage system and of all the other systems in the Leased.

15.3 The Lessee is obligated to preserve the cleanliness of the Leased and its surrounding, to prevent the accumulation of waste and materials which can cause a fire, and to prevent and remove odors, rust and to take any reasonable measures to prevent fire.

15.3.1 In order to remove any doubt, the Lessee declares that it is well aware, that there are and/or there will be other leaseds in its vicinity and that it should see to the installation of appliances and/or facilities and/or take the required measures in order to prevent loose materials and/or odors and/or hazardous materials originated in its plant and which may cause nuisance and/or contamination of other leaseds in its surrounding.

15.3.2 The Lessee shall avoid the causing of any nuisance, including the causing of noise, strong odors and shocks, which may interfere with leaseds adjacent to the Lessee.

Furthermore, the Lessee is obligated to take any required measure in order to prevent the bursting of fires.

15.4 The Lessee shall notify the Lessor of any damage to the Leased or of any nuisance that was caused to the Leased or to other leaseds, originating in the Leased, within 48 hours from its discovery. In the event, that the Lessee fails to notify as stated, the Lessee shall bear any additional expenses, caused to the Lessor in consequence of failure to notify the Lessor in due time.

15.5 The Lessee shall see to the proper maintenance of the Leased, including all its systems and including finish supplements and shall repair at

its expense any damage or spoilage in the Leased and/or its systems, including finish supplements, that being without prejudice to the liability of the Lessor with respect to the quality of the finish works, as stated in Section 6.2.10 above and/or any damage or spoilage, causing a nuisance to other leaseds in the vicinity of the Leased, which is caused or evolved or

discovered in the Leased or in any part thereof, including plumbing repairs and other various repairs, that being upon its evolving and/or causing and/or discovery, with the exception of damages to the Construction or to the systems, which are maintained by means of the Management Company in accordance with the Management Agreement, and which were not caused by the Lessee.

15.6 In the event, that the Lessee fails to perform its obligations or any of them in accordance with that stated in Section 15, including all its Sub-Sections, or if the damage is not repaired to the satisfaction of the engineer of the Lessor, the Lessor will be entitled, but not obligated, to perform the repairs by itself and all the expenses of such a repair shall apply to the Lessee, who will be obligated to refund them to the Lessor upon its first requirement, together with index linkage differences, as per Section 11 above, and arrears interest, as per Section 22 herebelow, calculated as from the payment date for the repair by the Lessor until the actual full payment to the Lessor.

The invoices of the Lessor with respect to the rate of its expenses, as per this Section, shall constitute a prima facie evidence to the correctness of said invoices, and the Lessee is obligated to pay them to the Lessor upon its first requirement.

15.7 The Lessee hereby gives its full consent and authorization, that the representatives of the Lessor, its employees and/or assignees will be entitled to enter the Leased following early coordination with the Lessee, at any reasonable time, in order to check the condition of the Leased, the fulfillment of the obligations of the Lessee in accordance with this Contract, the systems

of the Leased, its equipment and facilities, and also in order to carry out any repair and/or maintenance works, that the Lessor is obligated to perform in accordance with this Agreement and according to any Law whatsoever, for technical or other arrangements, and the representatives of the Lessor will also be entitled to enter the Leased, in order to show it to other potential lessees, that being during the last nine months of the lease period.

15.8 The Lessee shall fulfill all the instructions of the Lessor, the insurance company and the instructions of any other competent authority with regard to arrangements and procedures of fire extinguishing, prevention of fires, Civil Defense and safety, deriving from the activity of the Lessee in the Leased. Furthermore, the Lessee shall assume all measures required in order to prevent explosion and/or fire.

15.9 The Lessee is obligated to fulfill the provisions of any Law, regulation, order, sub-law or the instruction of any competent authority with regard to the management of its enterprise in the Leased and in connection with the holding of the Leased and the use thereof. The Lessee shall also be liable for the payment of any fine, imposed in consequence of a failure to fulfill the provisions, as stated above.

16. SAFE KEEP OF THE LEASED

16.1 The Lessee shall refrain from placing any equipment in the Leased, which may cause damage to the Leased, and shall refrain from loading the floor of the Leased in excess of the load for which it was intended. The permitted load for the floor of the offices is 500 kg. per sq. mtr. The permitted load in the parking lots is 250 kg. per sq. mtr.

16.2 In any event of a special or concentrated loading or basing of machinery, the Lessee must file a plan and receive the early approval in writing of the engineer of the Lessor.

17. SECURITIES AND GUARANTEES

17.1 For the assurance of all the obligations of the Lessee in accordance with this Contract, including all its Appendices, the Lessee shall furnish the Lessor upon the stand of signing this Agreement with an unconditional autonomic, financial bank guarantee of the Bank of Israel, made to the order of the Lessor, according to the draft of the guarantee

attached to this Contract, as Appendix I, that being according to an amount of NIS94,164, together with the addition of VAT. The guarantee shall be linked to the Basic Index, according to its definition in Section 8.3 above, and will remain valid for fifteen months from its issuance.

No later than thirty days prior to the commencement of each and every lease year, but not later than thirty days prior to the expiry of the validity of the guarantee, whichever is earlier, the guarantee shall be extended for an additional identical period, that being until the completion of the lease period plus ninety additional days after the completion of the lease period.

17.2 In order to remove any doubt, it is stipulated between the parties that the extension of the validity of the guarantees, upon the dates specified above, is among the fundamental obligations of the Lessee in accordance with this Contract, and that in the event that the guarantee is materialized by the Lessor, the Lessee will be obligated to furnish the Lessor with a new guarantee instead of the materialized guarantee, as stated above, within seven days from the receipt of a notice concerning the materialization of the guarantee.

17.3 Upon the completion of the lease period and upon the delivery of the Leased to the Lessor, the Lessee will be obligated to furnish the Lessor with

approvals concerning all the payments and fees applying to it and which were paid by it up until the vacating date of the Leased returning it to the Lessor and/or with respect to the lease period.

17.4 All the securities given to the Lessor in accordance with this Contract, including the bank guarantee, shall be returned to the Lessee three months from the completion of the lease period or the option period, as the case may be, subject to the fulfillment of that stated in Section 17.3 above.

In order to remove any doubt, it is hereby clarified that the signature of DSP Group on the guarantee for this Contract and also the depositing of the bank guarantee, as stated above, are fundamental conditions of this Contract.

18. THE USE OF OTHER AREAS OUTSIDE THE LEASED

18.1 The Lessee shall not have any contention toward the Lessor in the event of a decrease in the area of the premises, as a result of changes in the Planning or as a result of decisions or requirements of the competent authorities or due to any cause.

18.2 The Lessee will not be entitled to make any singular use whatsoever of the pavements, roads, staircases or in any other area outside the Leased.

The internal road at the front of the Leased is not intended for any use other than the passage of vehicles and to allow passengers off/on.

19. ELECTRICITY, WATER, CHANNELING AND SIGN POSTING

19.1 Without prejudice to anything else stated in this Contract herebelow, the Lessee approves that it is well aware that the installation of water inside the Leased and connecting the Leased to the water manhole, according to a contractual commitment between it and the local authority or the Management Company with respect to the installation of meters in the Leased and any payment in connection therewith shall apply to the Lessee.

19.2 The Lessee hereby agrees, that the failure to connect the Leased to the electricity network, as stated in Appendix H and/or to the water manhole shall not derogate from its obligations in accordance with this Contract, nor will it constitute a ground for claim of damages against the Lessor, so long as the Lessor supplies the Leased with electricity and water supply, alternatively and regularly, in a manner corresponding with the needs of the Lessee until the connecting of the Leased to the water manhole and to the electricity network, as per that stated in Appendix H.

Subject to the obligation of the Lessor to supply electricity, as stated above, it is agreed that the Lessor and the Lessor alone shall have the right to cease the power supply to the Construction in bulks and to see to the connecting of the Leased to the general electricity network of the Electricity Company, and the Lessee shall not have any contention toward the Lessor in this matter.

19.2.1 Notwithstanding that stated in Sections 19.1 - 19.2 above, the Lessee hereby declares and approves, that it was brought to its attention, that the Lessor will be entitled to install a central water faucet in the Construction, through which the entire water supply will be channeled to the Leased in the Construction. In such a case, the Lessee is obligated to pay to the Lessor or to anyone on its behalf for the water consumption of the Leased, immediately upon receipt of a requirement from the Lessor.

19.3 The Lessee hereby declares and approves, that it was brought to its attention, that all the electricity services to the Construction and to the Leased shall be supplied by the Lessor and/or anyone on its behalf, in bulk, and that no electricity services shall be given to the Construction and/or to the Leased by the Electricity Company.

19.3.1 The Lessee is obligated to pay to the Lessor and/or anyone on its behalf its share in the electricity expenses of the Leased, as specified in Appendix H to this Contract, the Electricity Appendix.

19.3.2 The Lessee is obligated to sign the Electricity Agreement, Appendix H, with the Lessee and/or anyone on its behalf and to bear all the payments for the electricity services only with respect to the Leased, as specified in Appendix H. In any event, the Lessee approves, that the provisions of Appendix H, containing the provisions specified in this Section, shall apply to the lease, subject to this Contract, whether the Lessee would sign said Agreement or not.

19.3.3 Without prejudice to the generality of that stated above, the payment obligation on the part of the Lessee in accordance with the provisions of the Electricity Agreement, Appendix H, should be viewed similarly as the obligation to pay the lease moneys and the provisions of the Electricity Agreement should be viewed as the provisions of this Agreement, the breach of which shall entitle the Lessor to all the relieves stated in this Contract. In order to remove any doubt, the provisions of Sections 11, 21.4 and 22 of the Contract shall apply to the obligations of the Lessee in accordance with the Electricity Agreement, that being without prejudice to any other relief given to the Lessor in accordance with the Electricity Agreement.

19.4 The Lessee is obligated to prevent blocks or spoilage in the sewage system of the Leased, as a result of the use of it or as a result of sewages from its plant and shall bear the expenses of repair or replacement of this system, in case of a spoilage or blocking caused in its direct responsibility.

19.5 The Lessee shall not install sign posts outside of the Leased or on the Leased, but only after receipt of the early approval in writing of the Lessee and/or the Management Company.

The Lessor and/or the Management Company will be entitled to determine the shape of the sign post, its size and location, and the Lessee will be obligated to install the sign post, as determined by the Lessor and/or the Management Company. In the event, that the Lessee installs a sign post while in breach of

this Section, the Lessor and/or the Management Company will be entitled to remove it at the expense of the Lessee.

19.6 The Lessee shall bear any tax or fee for the installation of the sign post and its maintaining and it will be responsible to obtain any permit, which is required for the installation of the sign post.

19.7 In the event, that the Lessor and/or the Management Company shall

install a uniform sign post for all the constructions, which were erected and/or would be erected by the Lessor in the area of the Leased, the Lessee will be obligated to pay a relative payment for the sign posting.

Any amount applying to the Lessee in accordance with this Sub-Section shall be regarded as lease moneys for each and every purpose.

19.8 The Lessor will be entitled to install on the roof of the Leased or in its premises, public sign posts pursuant to the advertising of the Lessor and/or its tenants in the Construction and/or the project, while maintaining the architectural and qualitative nature of the Construction, and the Lessee will not be entitled to object to their installation.

20. SUPPLY OF SERVICES AND JOINT FACILITIES

20.1 The Lessee will be entitled to use the joint facilities located in the area of the Leased, solely for the purpose for which they are designated, and all according to the instructions of the Lessor and/or the Management Company.

20.2 The Lessee hereby declares and approves, that it was brought to its intention, that for the purpose of the maintenance of the Leased, other leaseds in its area and the joint services of all the leaseds, including public areas, such as: external walls, public toilets, backyard and security rooms and their

facilities in the Construction, the Lessor shall provide management and maintenance services directly and/or by means of sub-contractor and/or by means of a service company (hereinafter: "The Management Company"). For the purpose of this Chapter: main systems, including systems of air-conditioning, lifts, electrical switchboards, installation, lighting, water, sewage and system channeling, fire extinguishing, emergency generator, smoke detection, public address system and the control systems. Furthermore, it was brought to the attention of the Lessee, that the Lessor is entitled to deliver the management of the parking lot to another organization, which would be referred to hereinafter, as "The Parking Lot Management Company".

20.4 The Lessee is obligated to sign the Management Agreement with the Lessor and/or the Management Company, according to the draft determined by the Lessor and/or the Management Company and also the Parking Lot Management Agreement with the Lessor and/or the Management Company and/or the Parking Lot Management Company, according to the draft of the Agreement, Appendix G, and to bear all the payments, as would be obliged by the Management Agreement and the Parking Lot Management Agreement. In any event, the Lessor approves that the provisions of the Management Agreement shall include all the provisions specified herebelow, and in any event of a discrepancy and/or disagreed supplement in deviation from that stated in this Contract - the provisions of this Contract shall supercede the provisions of the Management Agreement.

20.4.1 The parties agree, that the management and maintenance moneys, which the Lessee pays to the Lessor and/or the Management Company up until May 1st 1999 will be in the amount of NIS11.40 per sq. mtr. per month (an amount in Shekel equivalent to US \$3 per sq. mtr. per month) and in any event, the management and maintenance moneys shall not be above the management and maintenance moneys collected by the Lessor

from a similar lessee in the Construction (with the exception of additions for specific services rendered to the Lessee, as per its instructions). The management and maintenance moneys, payable by the Lessee as stated, will be linked to the index, all according to the provisions of Section 11 above. The management and maintenance moneys, upon the completion of the aforementioned period, shall be determined according to the cost of all the expenses, as per their definition herebelow, together with the addition of 15% and according to the relative share of the Leased out of the entire area.

20.4.2 The management and maintenance moneys, among others, shall include expenses for the operation of an information station, cleaning and gardening services, overhaul and repair services for the systems mentioned

above, electricity and water supply for the public areas, insurance for the public areas including breakage insurance and also the expenses of any other service, which is required according to the discretion of the Lessor and/or the Management Company, including allowances for an equipment renewal fund.

For a special service, which is not included within the general framework of the responsibility of the Management Company, and which is given to the Lessee and/or the Leased by the Management Company, as per the order of the Lessee, the Lessee shall pay an additional amount above the management and maintenance moneys.

20.3.3 The Lessor hereby agrees and is obligated to bear the relative share of payment for all the areas intended for lease and which are not leased.

20.3.4 It is agreed, that the Management Agreement shall include the following obligations:

20.4.4.1 The Management Company shall keep books and accounts, audited by an accountant, which would be available for the checking of the Lessee to the extent that it is required for the purpose of the determination of the management moneys.

20.4.4.2 The Lessee will not be entitled to offset amounts due to it from the Lessor from amounts that are due to the Management Company from it, nor will it be entitled to offset amounts due to it from the Management Company out of amounts that are due to the Lessor from it.

20.4.4.3 In the stand of the signing of this Contract, the Lessee shall furnish the Lessor with an autonomic bank guarantee to the order of the Lessor, according to the draft of Appendix I, in the amount of three months of management and maintenance together with the addition of VAT, that being for the assurance of the fulfillment of all the obligations of the Lessee toward the Management Company. The guarantee shall be linked to the Basic Index, according to its definition in Section 8.3 above, and will be valid for twelve months from its issuance.

20.5 Without prejudice to the generality of that stated above, The obligation to pay the management and maintenance moneys by the Lessee in accordance with the provisions of this Contract and/or the Management Agreement and the Parking Lot Management Agreement, Appendix G, shall be viewed as the obligation to pay the lease moneys and the provisions of the Management Agreement and the provisions of the Parking Lot Management Agreement shall be viewed as the provisions of this Contract, the breach of which shall entitle the Lessor to all the relieves stated in this Contract, without prejudice to any relief given to the Management Company and/or the Parking Lot Management Company in accordance with the Management Agreement and/or the Parking Lot Management Agreement and/or in accordance with any Law.

20.6 In the event of the rendering of services, as stated, by means of the Management Company and/or the Parking Lot Management Company, the meaning of the word "the Lessor" in this Section shall be the Lessor and/or the Management Company and/or the Parking Lot Management Company.

21. TAXES, FEES AND OBLIGATORY PAYMENTS

21.1 All the taxes, municipal taxes, payments, fees and various duties (hereinafter: "The Taxes") whether municipal, governmental or others, imposed or which would be imposed in the future on or in connection with the use of the Leased or in connection with the management of the business of the Lessee in the Leased during the lease period, shall apply and be borne by the Lessee as from the Delivery Date.

Notwithstanding that stated above, duties and/or fees imposed due to the development work and also lease moneys and betterment tax imposed on the Leased shall apply to the Lessor.

Municipal taxes imposed on the Leased shall apply in any event to the Lessee and be borne by it, that being even if it is determined by Law that

the tax will be paid by the Lessor and/or the owner of the land.

21.2 That stated above shall not be viewed as imposing an obligation on the Lessee to pay income tax and/or capital gain tax and/or property tax, applying and/or which would apply to the Leased.

21.3 Value Added Tax imposed on the Lessor or on the Lessee with respect to this lease shall apply to the Lessee alone and be paid by it against the furnishing of an appropriate tax invoice.

21.4 Each and every payment paid to the Lessor by the Lessee in accordance with this Contract shall be paid together with the addition of VAT, according to its lawful rate upon the payment date.

Notwithstanding that stated above and below, the Lessee will be entitled to delay the payment of VAT up until the lawful date for its transferring to the VAT Authorities.

21.5 Notwithstanding that stated above, but subject to that stated in Section 21.2, it is hereby agreed that in the event that a new tax is imposed on the Leased, the payment of which applies to owners of properties, such a tax and/or taxes as above shall be borne by the Lessee.

22 ARREARS INTEREST

22.1 Without prejudice to the generality of the rights of the Lessor according to this Contract or according to the Law, in any event in which the Lessee is in delay with any payment due to the Lessor in accordance with this Contract, the Lessee will be obligated to pay to the Lessor the amount in arrears together with a maximum rate of interest, accustomed at such time with Bank Discount of Israel Ltd., Central Branch Haifa, in a debit account, for overdraft above the maximum permitted overdraft (hereinafter: "The Interest") or linkage differences together with lawful interest on them, whichever is higher, as per the choosing of the Lessor, that being from the arrears date until the actual payment date.

22.2 The order and manner of crediting of payments made by the Lessee shall be determined by the Lessor, according to its discretion.

23. FRUSTRATION OF THE LEASE

23.1 In the event, that the Leased is damaged entirely or if the benefit from the Leased is entirely cancelled, this Contract shall come to its end and be viewed as cancelled, the Lessor shall refund to the Lessee same lease moneys or securities, received by the Lessor in advance for the period after the aforementioned event, that being according to the actual amount, that was paid, together with linkage.

24. LIABILITY AND INSURANCE

24.1 The Lessor, including according to its definition in Section 20.6 above, shall not bear any responsibility or liability whatsoever for any bodily

damage and/or loss and/or damage to property of any kind whatsoever (direct or indirect), which is caused to the Lessee and/or its workers and/or those employed by it and/or its agents and/or its clients and/or visitors and/or invitees and/or any other person located in the Leased or in another area held by the Lessee, in the premises of the Lessor or in the area adjacent to the Leased and/or to any other property of the Lessee and/or bodily damage or damage to property caused to the neighbors of the Lessee.

The Lessee assumes full liability for any of the damages specified above, and it is obligated to compensate and to indemnify the Lessor against any damages it might be obligated to pay or compelled to pay due to a damage of this sort and also against any expense incurred by the Lessor in connection with any damage as above, all subject to that, that in the event that any third party files a claim against the Lessor, the Lessor shall instigate third party proceedings against the Lessee.

The Lessor is obligated to compensate and indemnify the Lessee against any

damages it might be obligated to pay or which would be paid by it in consequence of a damage, as stated above, caused due to the negligence of the Lessor, subject to that, that to the extent that any third party files a claim against the Lessee, the Lessee shall instigate third party proceedings against the Lessor.

24.2 The Lessee undertakes to insure itself against third party liability, as specified in the Insurance Appendix, attached hereto and marked E, and it is also obligated to bear the payment for the insurance of the Construction, as specified in Section 24.15 of the Appendix E.

24.3 The payments, specified in Section 24.15 of the Appendix E shall be regarded as lease moneys for each and every purpose.

25. BREACH OF THE CONTRACT AND ITS CANCELLATION

25.1 Omitted.

25.2 Without prejudice to the provisions of any Law, any of the following actions or avoidance of actions shall be regarded as a fundamental breach of the Contract by the Lessee:

25.2.1 The use of the Leased not for the purpose of the lease, stated above.

25.2.2 The transferring of the rights of the Lessee in the Leased to another, in contrast with the provisions of Section 30 above.

25.2.3 The transferring of the control over the Lessee without the agreement of the Lessor, in contrast with the provisions of Section 13 above.

25.2.4 Failure to pay the lease moneys and/or the management moneys and/or the parking lot moneys and/or failure to pay any amount, which was paid by the Lessor in the stead of the Lessee upon the payment date and/or failure to deliver and/or renew the bank guarantee in accordance with the Contract and/or its Appendices.

It is hereby clarified, that a delay with a payment or delivery, as stated, not exceeding five days, shall not be regarded as breach of this Agreement.

25.2.5 The issuance of a receiving order or a liquidation order or the appointment of a receiver for all the assets of the Lessee or for any part thereof, whether such an order is temporary or permanent, and which is not be revoked within sixty days from its issuance.

25.2.6 The causing of a significant nuisance, which may interfere with enterprises or businesses, existing and/or which would exist nearby the Leased and/or the removal of a nuisance, as stated.

25.2.7 Failure to transfer possession of the Leased upon the date, in the manner and according to the condition, as specified in Section 26 herebelow.

25.2.8 The performance of an action in contrast with the provisions of Sections 14, 15 and 16 above.

25.2.9 Failure to pay for the services rendered to the Leased in accordance with the Management Agreement and/or Parking Lot Management Agreement and/or the Electricity Agreement.

25.3 In the event, that the Lessee breaches any of the aforementioned fundamental conditions and fails to cure the breach within ten days from the receipt of a warning in writing of the Lessor, the Lessor will be entitled to cancel this Contract and this Contract shall be regarded as cancelled from the date fixed in the notice of the Lessor.

25.4 In the event, that the Lessor lawfully notifies the Lessee of the cancellation of the Contract, the Lessee shall vacate the Leased and return possession thereof to the Lessor, as the Leased is clear and vacant of any holder and object, within thirty days from the receipt of the notice with

respect to the cancellation of this Contract, and shall compensate the Lessor for any damage caused to it.

25.5 The provisions of this Section shall not derogate from other rights of any of the parties in accordance with this Contract or by Law.

25.6 Any absence of an action and/or the lack of response and/or avoidance of a use of a remedy by the Lessor, as per this Section, shall not be construed in any way or manner as a waiver on its part of its rights in accordance with the Contract, in case of a prolonged or additional breach on the part of the Lessee, unless the Lessor waived its aforementioned rights in advance, explicitly and in writing.

26. VACATING THE LEASED

26.1 The Lessee shall vacate the Leased upon the completion of the lease period or upon any date in which the lease is terminated in accordance with

this Contract, and it will return it to the Lessor as it is clear of any person and object, as per that stated in this Section. In any event in which the Lessee should vacate the Leased according to this Contract, it is obligated to return it to the Lessor as it is absolutely clear and in a good condition worthy for immediate use, to the satisfaction of the engineer of the Lessor, with the exception of wear and tear deriving from reasonable normal use of the Leased.

26.2 In the event, that the Lessee did not vacate the Leased, as stated in Sub-Section 1 above and in Section 25.4 above, the Lessee shall pay to the Lessor a fixed and evaluated in advance compensation in a rate equivalent to 200% of the basic lease moneys for each month of delay, and also another relative rate for additional days of arrears, that being together with the addition of linkage differences between the Basic Index and the index recently published prior to the actual payment. In addition to that, the Lessee will pay to the Lessor any damage or loss, which is caused to the Lessor or to a third party, as a result of a delay with the vacating of the Leased and its leasing to a new lessee by the Lessor.

27. EXPENSES OF THE CONTRACT AND LEGAL EXPENSES

27.1 Stamp duty of this Contract shall apply to the parties in equal parts. The stamping expenses of the guarantees, subject to this Contract, shall apply to the Lessee.

27.2 It has been agreed and declared between the parties, that in the event that the Lessee shall not vacate the Leased upon the completion of the lease period or after receiving a notice with respect to the cancellation of the lease in accordance with the provisions of this Contract or in any event that the Lessee breaches any of the provisions of this Agreement, the Lessee, in addition to all the relieves stated in this Contract and by Law, will bear all the

expenses incurred by the Lessor in all matters pertaining to the legal handling in connection with any hearing or legal claim or an action with the Execution Bureau, including legal fees incurred by the Lessor, all in accordance with the judgment of the Court and/or any other judicial institute.

28. AMENDMENT OF THE CONTRACT

Any change and/or amendment to this Contract shall only be made by way of an explicit document in writing, signed by the parties to the Contract.

29. DEVIATION

The agreement of a party to this Contract to deviate from its conditions in a certain case or in a series of cases shall not constitute a precedent and it shall be not drawn by comparison by analogy to another case in the future.

30. NOTICES AND WARNINGS

30.1 Any notice or warning, passed by one party to the other in connection with this Contract, shall be passed by means of registered mail or delivered by hand according to the addresses of the parties, as stated in the preamble to this Contract (or to any other address according to a notice in writing) and such a notice or a warning, as stated, shall be viewed as if delivered to the addressee upon the actual delivery - if it was delivered by hand, and if passed by the Israeli Post - within seventy two hours after its delivery by mail, as postal moneys are fully paid in advance.

30.2 The addresses of the parties are as specified in the preamble to this Contract.

31. ADDITIONAL STEPS

The parties shall take any additional steps (including the signing of additional documents), as would be required for the execution of the Contract to its spirit and wording.

32. GENERAL

32.1 Any waiver, negligence, disregard or failure to take legal means or a delay with the exercise of the rights on the part of the Lessor in a certain case shall in no way be viewed as a waiver, consent or acknowledgement on the part of the Lessor. The Lessor will be entitled to exercise any of its rights in accordance with this Contract or by Law at any time whatsoever, and whenever it is found to be in place despite any prior waivers, discounts or negligence.

32.2 For the purposes of this Lease Contract, including all its Appendices and everything deriving therefrom, including a claim for its breach, the parties determined that the competent Court of Haifa is the exclusive and singular venue and no other Court.

32.3 Any notice in accordance with this Agreement shall be given, in the absence of another determination, in writing seven business days in advance.

In witness thereof, the parties have signed:

DSP Group Ltd.

Bayside Land Corporation Ltd.

(signature)

(signature)

/s/ Eliyahu Ayalon

/s/ Hanan Nitsan

/s/ Noach Aviram

The Lessee

The Lessor

DSP GROUP, INC.

1998 NON-OFFICER EMPLOYEE STOCK OPTION PLAN

1. PURPOSES OF THE PLAN. The purposes of this Non-Officer Employee Stock Option Plan are to attract and retain the best available personnel, to provide additional incentive to Employees (excluding Officers) and to promote the success of the Company's business.

2. DEFINITIONS. As used herein, the following definitions shall apply:

(a) "ADMINISTRATOR" means the Board or any of the Committees appointed to administer the Plan.

(b) "AFFILIATE" and "ASSOCIATE" shall have the respective meanings ascribed to such terms in Rule 12b-2 promulgated under the Exchange Act.

(c) "APPLICABLE LAWS" means the legal requirements relating to the administration of stock option plans, if any, under applicable provisions of federal securities laws, state corporate and securities laws, the Code, the rules of any applicable stock exchange or national market system, and the rules of any foreign jurisdiction applicable to Awards granted to residents therein.

(d) "AWARD" means the grant of an Non-Qualified Stock Option or other right or benefit under the Plan.

(e) "AWARD AGREEMENT" means the written agreement evidencing the grant of an Award executed by the Company and the Grantee, including any amendments thereto.

(f) "BOARD" means the Board of Directors of the Company.

(g) "CHANGE IN CONTROL" means a change in ownership or control of the Company effected through either of the following transactions:

(i) the direct or indirect acquisition by any person or related group of persons (other than an acquisition from or by the Company or by a Company-sponsored employee benefit plan or by a person that directly or indirectly controls, is controlled by, or is under common control with, the Company) of beneficial ownership (within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities pursuant to a tender or exchange offer made directly to the Company's stockholders which a majority of the Continuing Directors who are not Affiliates or Associates of the offeror do not recommend such stockholders accept, or

(ii) a change in the composition of the Board over a period of twenty-four (24) months or less such that a majority of the Board members (rounded up to the next whole number) ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who are Continuing Directors.

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(h) "CODE" means the Internal Revenue Code of 1986, as amended.

(i) "COMMITTEE" means any committee appointed by the Board to administer the Plan.

(j) "COMMON STOCK" means the common stock of the Company.

(k) "COMPANY" means DSP Group, Inc., a Delaware corporation.

(l) "CONSULTANT" means any person (other than an Employee or, solely with respect to rendering services in such person's capacity as a Director) who is engaged by the Company or any Related Entity to render consulting or advisory services to the Company or such Related Entity.

(m) "CONTINUING DIRECTORS" means members of the Board who either (i) have been Board members continuously for a period of at least twenty-four

(24) months or (ii) have been Board members for less than twenty-four (24) months and were elected or nominated for election as Board members by at least a majority of the Board members described in clause (i) who were still in office at the time such election or nomination was approved by the Board.

(n) "CONTINUOUS SERVICE" means that the provision of services to the Company or a Related Entity in any capacity of Employee, Director or Consultant, is not interrupted or terminated. Continuous Service shall not be considered interrupted in the case of (i) any approved leave of absence, (ii) transfers between locations of the Company or among the Company, any Related Entity, or any successor, in any capacity of Employee, Director or Consultant, or (iii) any change in status as long as the individual remains in the service of the Company or a Related Entity in any capacity of Employee, Director or Consultant (except as otherwise provided in the Award Agreement). An approved leave of absence shall include sick leave, military leave, or any other authorized personal leave.

(o) "CORPORATE TRANSACTION" means any of the following transactions:

(i) a merger or consolidation in which the Company is not the surviving entity, except for a transaction the principal purpose of which is to change the state in which the Company is incorporated;

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company (including the capital stock of the Company's subsidiary corporations) in connection with the complete liquidation or dissolution of the Company;

(iii) any reverse merger in which the Company is the surviving entity but in which securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from those who held such securities immediately prior to such merger; or

(iv) an acquisition by any person or related group of persons (other than the Company or by a Company-sponsored employee benefit plan) of beneficial ownership

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(within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities (whether or not in a transaction also constituting a Change in Control), but excluding any such transaction that the Administrator determines shall not be a Corporate Transaction.

(p) "DIRECTOR" means a member of the Board or the board of directors of any Related Entity.

(q) "DISABILITY" means that a Grantee would qualify for benefit payments under the long-term disability policy of the Company or the Related Entity to which the Grantee provides services regardless of whether the Grantee is covered by such policy.

(r) "EMPLOYEE" means any person who is an employee of the Company or any Related Entity. The payment of a director's fee by the Company or a Related Entity shall not be sufficient to constitute "employment" by the Company.

(s) "EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended.

(t) "FAIR MARKET VALUE" means, as of any date, the value of Common Stock determined as follows:

(i) Where there exists a public market for the Common Stock, the Fair Market Value shall be (A) the closing price for a Share for the last market trading day prior to the time of the determination (or, if no closing price was reported on that date, on the last trading date on which a closing price was reported) on the stock exchange determined by the Administrator to be the primary market for the Common Stock or the Nasdaq National Market, whichever is applicable or (B) if the Common Stock is not traded on any such exchange or national market system, the average of the closing bid and asked prices of a Share on the Nasdaq Small Cap Market for the day prior to the time of the

determination (or, if no such prices were reported on that date, on the last date on which such prices were reported), in each case, as reported in THE WALL STREET JOURNAL or such other source as the Administrator deems reliable; or

(ii) In the absence of an established market for the Common Stock of the type described in (i), above, the Fair Market Value thereof shall be determined by the Administrator in good faith.

(u) "GRANTEE" means an Employee who receives an Award pursuant to an Award Agreement under the Plan.

(v) "NON-QUALIFIED STOCK OPTION" means an Option not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

(w) "OFFICER" means a person who is an officer of the Company or a Related Entity within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

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(x) "OPTION" means an option to purchase Shares pursuant to an Award Agreement granted under the Plan.

(y) "PARENT" means a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(z) "PLAN" means this 1998 Non-Officer Employee Stock Option Plan.

(aa) "RELATED ENTITY" means any Parent, Subsidiary and any business, corporation, partnership, limited liability company or other entity in which the Company, a Parent or a Subsidiary holds a substantial ownership interest, directly or indirectly.

(bb) "RULE 16b-3" means Rule 16b-3 promulgated under the Exchange Act or any successor thereto.

(cc) "SHARE" means a share of the Common Stock.

(dd) "SUBSIDIARY" means a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code.

(ee) "RELATED ENTITY DISPOSITION" means the sale, distribution or other disposition by the Company of all or substantially all of the Company's interests in any Related Entity effected by a sale, merger or consolidation or other transaction involving that Related Entity or the sale of all or substantially all of the assets of that Related Entity.

3. STOCK SUBJECT TO THE PLAN.

(a) Subject to the provisions of Section 10, below, the maximum aggregate number of Shares which may be issued pursuant to all Awards is 950,000 Shares. The Shares to be issued pursuant to Awards may be authorized, but unissued, or reacquired Common Stock.

(b) Any Shares covered by an Award (or portion of an Award) which is forfeited or canceled, expires or is settled in cash, shall be deemed not to have been issued for purposes of determining the maximum aggregate number of Shares which may be issued under the Plan. If any unissued Shares are retained by the Company upon exercise of an Award in order to satisfy the exercise price for such Award or any withholding taxes due with respect to such Award, such retained Shares subject to such Award shall become available for future issuance under the Plan (unless the Plan has terminated). Shares that actually have been issued under the Plan pursuant to an Award shall not be returned to the Plan and shall not become available for future issuance under the Plan, except that if unvested Shares are forfeited, or repurchased by the Company at their original purchase price, such Shares shall become available for future grant under the Plan.

4. ADMINISTRATION OF THE PLAN.

(a) PLAN ADMINISTRATOR.

(i) ADMINISTRATION. The Plan shall be administered by (A) the Board or (B) a Committee designated by the Board, which Committee shall be constituted in such a manner as to satisfy the Applicable Laws. Once appointed, such Committee shall continue to serve in its designated capacity until otherwise directed by the Board. The Board may authorize one or more Officers to grant such Awards and may limit such authority as the Board determines from time to time.

(ii) ADMINISTRATION ERRORS. In the event an Award is granted in a manner inconsistent with the provisions of this subsection (a), such Award shall be presumptively valid as of its grant date to the extent permitted by the Applicable Laws.

(b) POWERS OF THE ADMINISTRATOR. Subject to Applicable Laws and the provisions of the Plan (including any other powers given to the Administrator hereunder), and except as otherwise provided by the Board, the Administrator shall have the authority, in its discretion:

(i) to select the Employees to whom Awards may be granted from time to time hereunder;

(ii) to determine whether and to what extent Awards are granted hereunder;

(iii) to determine the number of Shares or the amount of other consideration to be covered by each Award granted hereunder;

(iv) to approve forms of Award Agreements for use under the Plan;

(v) to determine the terms and conditions of any Award granted hereunder;

(vi) to amend the terms of any outstanding Award granted under the Plan, provided that any amendment that would adversely affect the Grantee's rights under an outstanding Award shall not be made without the Grantee's written consent;

(vii) to construe and interpret the terms of the Plan and Awards granted pursuant to the Plan, including without limitation, any notice of Award or Award Agreement, granted pursuant to the Plan;

(viii) to establish additional terms, conditions, rules or procedures to accommodate the rules or laws of applicable foreign jurisdictions and to afford Grantees favorable treatment under such laws; provided, however, that no Award shall be granted under any such additional terms, conditions, rules or procedures with terms or conditions which are inconsistent with the provisions of the Plan; and

(ix) to take such other action, not inconsistent with the terms of the Plan, as the Administrator deems appropriate.

(c) EFFECT OF ADMINISTRATOR'S DECISION. All decisions, determinations and interpretations of the Administrator shall be conclusive and binding on all persons.

5. ELIGIBILITY. Awards may be granted to Employees, excluding Officers. An Employee who has been granted an Award may, if otherwise eligible, be granted additional Awards. Awards may be granted to such Employees (excluding Officers) who are residing in foreign jurisdictions as the Administrator may determine from time to time.

6. TERMS AND CONDITIONS OF AWARDS.

(a) CONDITIONS OF AWARD. Subject to the terms of the Plan, the Administrator shall determine the provisions, terms, and conditions of each Award including, but not limited to, the Award vesting schedule, repurchase

provisions, rights of first refusal, forfeiture provisions, form of payment (cash, Shares, or other consideration) upon settlement of the Award, payment contingencies, and satisfaction of any performance criteria. The performance criteria established by the Administrator may be based on any one of, or combination of, increase in share price, earnings per share, total stockholder return, return on equity, return on assets, return on investment, net operating income, cash flow, revenue, economic value added, personal management objectives, or other measure of performance selected by the Administrator. Partial achievement of the specified criteria may result in a payment or vesting corresponding to the degree of achievement as specified in the Award Agreement.

(b) ACQUISITIONS AND OTHER TRANSACTIONS. The Administrator may issue Awards under the Plan in settlement, assumption or substitution for, outstanding awards or obligations to grant future awards in connection with the Company or a Related Entity acquiring another entity, an interest in another entity or an additional interest in a Related Entity whether by merger, stock purchase, asset purchase or other form of transaction.

(c) DEFERRAL OF AWARD PAYMENT. The Administrator may establish one or more programs under the Plan to permit selected Grantees the opportunity to elect to defer receipt of consideration upon exercise of an Award, satisfaction of performance criteria, or other event that absent the election would entitle the Grantee to payment or receipt of Shares or other consideration under an Award. The Administrator may establish the election procedures, the timing of such elections, the mechanisms for payments of, and accrual of interest or other earnings, if any, on amounts, Shares or other consideration so deferred, and such other terms, conditions, rules and procedures that the Administrator deems advisable for the administration of any such deferral program.

(d) SEPARATE PROGRAMS. The Administrator may establish one or more separate programs under the Plan for the purpose of issuing particular forms of Awards to one or more classes of Grantees on such terms and conditions as determined by the Administrator from time to time.

(e) EARLY EXERCISE. The Award Agreement may, but need not, include a provision whereby the Grantee may elect at any time while in Continuous Service to exercise any part or all of the Award prior to full vesting of the Award. Any unvested Shares received pursuant to

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such exercise may be subject to a repurchase right in favor of the Company or a Related Entity or to any other restriction the Administrator determines to be appropriate.

(f) TERM OF AWARD. The term of each Award shall be the term stated in the Award Agreement.

(g) TRANSFERABILITY OF AWARDS. Awards shall be transferable to the extent provided in the Award Agreement.

(h) TIME OF GRANTING AWARDS. The date of grant of an Award shall for all purposes be the date on which the Administrator makes the determination to grant such Award, or such other date as is determined by the Administrator. Notice of the grant determination shall be given to each Employee to whom an Award is so granted within a reasonable time after the date of such grant.

7. AWARD EXERCISE OR PURCHASE PRICE, CONSIDERATION, AND TAXES.

(a) EXERCISE OR PURCHASE PRICE. The exercise price for an Award shall be determined by the Administrator.

(b) CONSIDERATION. Subject to Applicable Laws, the consideration to be paid for the Shares to be issued upon exercise of an Award including the method of payment, shall be determined by the Administrator. In addition to any other types of consideration the Administrator may determine, the Administrator is authorized to accept as consideration for Shares issued under the Plan the following, provided that the portion of the consideration equal to the par value of the Shares must be paid in cash or other legal consideration permitted by the Delaware General Corporation Law:

(i) cash;

(ii) check;

(iii) delivery of Grantee's promissory note with such recourse, interest, security, and redemption provisions as the Administrator determines as appropriate;

(iv) surrender of Shares or delivery of a properly executed form of attestation of ownership of Shares as the Administrator may require (including withholding of Shares otherwise deliverable upon exercise of the Award) which have a Fair Market Value on the date of surrender or attestation equal to the aggregate exercise price of the Shares as to which said Award shall be exercised (but only to the extent that such exercise of the Award would not result in an accounting compensation charge with respect to the Shares used to pay the exercise price unless otherwise determined by the Administrator);

(v) with respect to Options, payment through a broker-dealer sale and remittance procedure pursuant to which the Grantee (A) shall provide written instructions to a Company designated brokerage firm to effect the immediate sale of some or all of the purchased Shares and remit to the Company, out of the sale proceeds available on the settlement date,

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sufficient funds to cover the aggregate exercise price payable for the purchased Shares and (B) shall provide written directives to the Company to deliver the certificates for the purchased Shares directly to such brokerage firm in order to complete the sale transaction; or

(vi) any combination of the foregoing methods of payment.

(c) TAXES. No Shares shall be delivered under the Plan to any Grantee or other person until such Grantee or other person has made arrangements acceptable to the Administrator for the satisfaction of any foreign, federal, state, or local income and employment tax withholding obligations, including, without limitation, obligations incident to the receipt of Shares. Upon exercise of an Award, the Company shall withhold or collect from Grantee an amount sufficient to satisfy such tax obligations.

8. EXERCISE OF AWARD.

(a) PROCEDURE FOR EXERCISE; RIGHTS AS A STOCKHOLDER.

(i) Any Award granted hereunder shall be exercisable at such times and under such conditions as determined by the Administrator under the terms of the Plan and specified in the Award Agreement.

(ii) An Award shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Award by the person entitled to exercise the Award and full payment for the Shares with respect to which the Award is exercised, including, to the extent selected, use of the broker-dealer sale and remittance procedure to pay the purchase price as provided in Section 7(b)(v). Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to Shares subject to an Award, notwithstanding the exercise of an Option or other Award. The Company shall issue (or cause to be issued) such stock certificate promptly upon exercise of the Award. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in the Award Agreement or Section 10, below.

(b) EXERCISE OF AWARD FOLLOWING TERMINATION OF CONTINUOUS SERVICE.

(i) An Award may not be exercised after the termination date of such Award set forth in the Award Agreement and may be exercised following the termination of a Grantee's Continuous Service only to the extent provided in the Award Agreement.

(ii) Where the Award Agreement permits a Grantee to exercise an Award following the termination of the Grantee's Continuous Service for a

specified period, the Award shall terminate to the extent not exercised on the last day of the specified period or the last day of the original term of the Award, whichever occurs first.

(c) BUYOUT PROVISIONS. The Administrator may at any time offer to buy out for a payment in cash or Shares, an Award previously granted, based on such terms and conditions as

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the Administrator shall establish and communicate to the Grantee at the time that such offer is made.

9. CONDITIONS UPON ISSUANCE OF SHARES.

(a) Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares pursuant thereto shall comply with all Applicable Laws, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any Applicable Laws.

10. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION. Subject to any required action by the shareholders of the Company, the number of Shares covered by each outstanding Award, and the number of Shares which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan, the exercise or purchase price of each such outstanding Award, as well as any other terms that the Administrator determines require adjustment shall be proportionately adjusted for (i) any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Shares, (ii) any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company, or (iii) as the Administrator may determine in its discretion, any other transaction with respect to Common Stock to which Section 424(a) of the Code applies; provided, however that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Administrator and its determination shall be final, binding and conclusive. Except as the Administrator determines, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason hereof shall be made with respect to, the number or price of Shares subject to an Award.

11. CORPORATE TRANSACTIONS/CHANGES IN CONTROL/RELATED ENTITY DISPOSITIONS. The Administrator shall have the authority, exercisable either in advance of any actual or anticipated Corporate Transaction, Change in Control or Related Entity Disposition or at the time of an actual Corporate Transaction, Change in Control or Related Entity Disposition and exercisable at the time of the grant of an Award under the Plan or any time while an Award remains outstanding, to provide for the full automatic vesting and exercisability of one or more outstanding unvested Awards under the Plan and the release from restrictions on transfer and repurchase or forfeiture rights of such Awards in connection with a Corporate Transaction, Change in Control or Related Entity Disposition, on such terms and conditions as the Administrator may specify. The Administrator also shall have the authority to condition any such Award vesting and exercisability or release from such limitations upon the subsequent termination of the Continuous Service of the Grantee within a specified period following the

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effective date of the Corporate Transaction, Change in Control or Related Entity Disposition. The Administrator may provide that any Awards so vested or released from such limitations in connection with a Change in Control or Related Entity Disposition, shall remain fully exercisable until the

expiration or sooner termination of the Award. Effective upon the consummation of a Corporate Transaction, all outstanding Awards under the Plan shall terminate unless assumed by the successor company or its Parent.

12. EFFECTIVE DATE AND TERM OF PLAN. The Plan shall become effective upon its adoption by the Board. It shall continue in effect for a term of ten (10) years unless sooner terminated. Subject to Section 16, below, and Applicable Laws, Awards may be granted under the Plan upon its becoming effective.

13. AMENDMENT, SUSPENSION OR TERMINATION OF THE PLAN.

(a) The Board may at any time amend, suspend or terminate the Plan. To the extent necessary to comply with Applicable Laws, the Company shall obtain stockholder approval of any Plan amendment in such a manner and to such a degree as required.

(b) No Award may be granted during any suspension of the Plan or after termination of the Plan.

(c) Any amendment, suspension or termination of the Plan (including termination of the Plan under Section 12, above) shall not affect Awards already granted, and such Awards shall remain in full force and effect as if the Plan had not been amended, suspended or terminated, unless mutually agreed otherwise between the Grantee and the Administrator, which agreement must be in writing and signed by the Grantee and the Company.

14. RESERVATION OF SHARES.

(a) The Company, during the term of the Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

(b) The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

15. NO EFFECT ON TERMS OF EMPLOYMENT RELATIONSHIP. The Plan shall not confer upon any Grantee any right with respect to the Grantee's Continuous Service, nor shall it interfere in any way with his or her right or the Company's right to terminate the Grantee's Continuous Service at any time, with or without cause.

16. NO EFFECT ON RETIREMENT AND OTHER BENEFIT PLANS. Except as specifically provided in a retirement or other benefit plan of the Company or a Related Entity, Awards shall not be deemed compensation for purposes of computing benefits or contributions under any retirement plan of the Company or a Related Entity, and shall not affect any benefits under any other benefit

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plan of any kind or any benefit plan subsequently instituted under which the availability or amount of benefits is related to level of compensation. The Plan is not a "Retirement-Plan" or "Welfare Plan" under the Employee Retirement Income Security Act of 1974, as amended.

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DSP Group Inc.

Selected Consolidated Financial Data

| | YEAR ENDED DECEMBER 31, | | | | |
|---|--|----------|----------|----------|----------|
| | 1998 | 1997 | 1996 | 1995 | 1994 |
| | (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | | | | |
| STATEMENTS OF OPERATIONS DATA: | | | | | |
| Revenues | \$63,850 | \$61,959 | \$52,910 | \$50,347 | \$28,604 |
| Income (loss) from continuing operations | \$14,415 | \$11,034 | \$ 5,979 | \$ 7,211 | \$ 4,032 |
| Weighted average number of common shares outstanding during the period used to compute basic earnings per share | 9,768 | 9,736 | 9,510 | 9,352 | 8,111 |
| Weighted average number of common shares outstanding during the period used to compute diluted earnings per share | 10,016 | 10,203 | 9,581 | 9,658 | 9,135 |
| Net income (loss) per share - Basic | \$ 1.48 | \$ 1.13 | \$.63 | \$.77 | \$.50 |
| Net income (loss) per share - Diluted | \$ 1.44 | \$ 1.08 | \$.62 | \$.75 | \$.44 |
| BALANCE SHEET DATA: | | | | | |
| Cash, cash equivalents and marketable securities | \$66,989 | \$65,944 | \$42,934 | \$33,828 | \$26,376 |
| Working capital | \$68,673 | \$66,947 | \$47,851 | \$39,304 | \$29,824 |
| Total assets | \$85,791 | \$85,826 | \$59,778 | \$55,350 | \$43,832 |
| Total stockholders' equity | \$75,695 | \$74,170 | \$54,449 | \$47,541 | \$36,801 |

| | FISCAL YEARS BY QUARTER | | | | | | | |
|--------------------------------|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | 1998 | | | | 1997 | | | |
| | (UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | | | | | | | |
| QUARTERLY DATA: | 4TH | 3RD | 2ND | 1ST | 4TH | 3RD | 2ND | 1ST |
| Revenues | \$ 14,117 | \$ 17,308 | \$ 16,749 | \$ 15,676 | \$ 16,581 | \$ 16,558 | \$ 14,642 | \$ 14,178 |
| Gross profit | \$ 8,742 | \$ 9,041 | \$ 8,756 | \$ 7,883 | \$ 8,697 | \$ 8,050 | \$ 6,595 | \$ 6,305 |
| Net income | \$ 3,468 | \$ 3,475 | \$ 4,261 | \$ 3,211 | \$ 3,445 | \$ 3,348 | \$ 2,225 | \$ 2,016 |
| Net income per share - Basic | \$.37 | \$.36 | \$.43 | \$.32 | \$.34 | \$.34 | \$.23 | \$.21 |
| Net income per share - Diluted | \$.36 | \$.35 | \$.42 | \$.31 | \$.33 | \$.32 | \$.23 | \$.21 |

DSP Group Inc.

Price Range of Common Stock

The Company's common stock trades on the Nasdaq National Market (Nasdaq symbol "DSPG"). The following table presents for the periods indicated the intraday high and low sale prices for the Company's common stock as reported by the Nasdaq National Market:

| | HIGH | LOW |
|----------------|---------|---------|
| 1998 | | |
| First Quarter | \$26.88 | \$16.75 |
| Second Quarter | \$25.00 | \$16.88 |
| Third Quarter | \$24.75 | \$13.13 |
| Fourth Quarter | \$20.88 | \$ 9.63 |
| 1997 | | |
| First Quarter | \$13.00 | \$ 8.50 |
| Second Quarter | \$15.50 | \$ 8.50 |
| Third Quarter | \$40.38 | \$15.06 |
| Fourth Quarter | \$42.25 | \$17.94 |

As of December 31, 1998, there were approximately 88 holders of record of the Company's Common Stock, which the Company believes represents approximately 4,230 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITIONS AND RESULTS OF OPERATIONS
1998

RESULTS OF OPERATIONS

1998 has been a successful year for DSP Group's research and development team, which undertook and successfully completed an ambitious project of renewing our entire line of products. We also launched two new Core technology generations, the TeakDSPCore-Registered Trademark- and PalmDSPCore.-TM- Moreover, our results of operations for 1998 show increased licensing revenues and improved product gross margins. As a result, DSP Group has entered 1999 as a world leader in its advanced technologies and products.

DSP Group's liquidity and working capital continually improved throughout 1998 and by year end we achieved new record highs for DSP Group in cash and marketable securities and working capital. These increases were attained despite our repurchase program of DSP Group common stock during 1998 in the approximate aggregate amount of \$14 million. Throughout 1998, DSP Group maintained its role as a leading supplier of technologically advanced, high performance, cost effective signal processors.

Our future operating results will be dependent upon a variety of factors. See "Factors Affecting Operating Results" in this report and in our Annual Report on Form 10-K for the year ended December 31, 1998.

TOTAL REVENUES. Our total revenues were \$63.9 million in 1998, \$62.0 million in 1997 and \$52.9 million in 1996. This represents an increase in total revenues of 3% in 1998 as compared with total revenues in 1997, and a 17% increase in total revenues in 1997 as compared with those in 1996. However, in the fourth quarter of 1998, there was a sharp decline in our product revenues as a result of the phasing out of our previous line of D6K series products. Our licensing revenues in 1998 were \$14.6 million compared to \$10.7 million in 1997, and \$11.6 million in 1996. This represents an increase in licensing revenues of 36% in 1998 as compared with 1997,

and a decrease of 8% in our licensing revenues in 1997 as compared with those in 1996.

Export sales, primarily consisting of TAD speech processors shipped to manufacturers in Europe and Asia, including Japan, represented 95% of DSP Group's total revenues in 1998, 92% in 1997 and 91% in 1996. All export sales are denominated in U.S. dollars.

SIGNIFICANT CUSTOMERS. Revenues from one of our distributors, Tomen Electronics, accounted for 45% of our total revenues in 1998 as compared to 33% in 1997, and 17% in 1996. In addition, revenues from Samsung Semiconductor Inc. accounted for 11% of our total revenues in 1996. The loss of one or more of our major distributors or customers could harm our business, financial condition and results of operations.

GROSS PROFIT. Gross profit as a percentage of total revenues increased to 54% in 1998, from 48% in 1997 and from 42% in 1996. The increase in gross profit in 1998 compared to 1997 was primarily due to the increase in our licensing revenues, which have a higher gross profit than product sales.

Product gross profit as a percentage of product sales increased to 41% in 1998, from 39% in 1997 and from 29% in 1996. This ongoing increase was primarily due to the decrease in our costs of manufacturing. Our manufacturing costs have decreased due to improvements in manufacturing technology and the decreased manufacturing prices obtained from our foundries. Importantly, this increase in gross profit was achieved even though we continue to experience competitive, downward pricing pressure for our TAD products.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses increased to \$10.2 million in 1998, from \$8.4 million in 1997. This increase

in research and development expenses in 1998 as compared to those in 1997 was attributable mainly to an increase in the external services provided to our research and development team, additional mask tapeouts for our new enhanced line of products, and an increase in our research and development personnel.

The slight decrease in research and development expenses to \$8.4 million in 1997 compared to \$8.5 million in 1996 occurred as we finalized the consolidation of

our research and development activities in Israel, which resulted in a closely managed, more efficient and better focused research team. Research and development expenses as a percentage of total revenues increased to 16% in 1998, from 14% in 1997. In 1996, research and development expenses as a percentage of total revenues was 16%.

SALES AND MARKETING EXPENSES. Our sales and marketing expenses increased to \$5.2 million in 1998, from \$4.9 million in 1997 and from \$4.4 million in 1996. The increase in expenses in 1998 as compared to those in 1997 was due to an increase in our sales and marketing personnel, which was partially offset by lower sales commissions and lower consulting costs.

Sales and marketing expenses increased from \$4.4 million in 1996 to \$4.9 million in 1997 primarily due to our establishment of a new worldwide marketing group and extensive participation in trade shows and professional conferences.

Sales and marketing expenses as a percentage of total revenues remained at 8% in 1998, 1997 and 1996.

GENERAL AND ADMINISTRATIVE EXPENSES. Our general and administrative expenses increased only slightly to \$4.6 million in 1998 from \$4.5 million in 1997 as we continued to closely monitor these expenses.

General and administrative expenses decreased significantly in 1997 to \$4.5 million from \$5.7 million in 1996 mainly due to a decrease in salary and fringe benefits expense and legal expenses, as well as our closer monitoring of other expenses, including facilities rent, maintenance and insurance expenses.

General and administrative expenses as a percentage of total revenues remained at 7% in both 1998 and 1997 after a decrease from 11% in 1996.

UNUSUAL ITEMS. In July 1996, DSP Group made an initial cash investment of \$2.0 million for approximately 40% of the equity interests in Aptel Ltd. ("Aptel"), which is located in Israel. In connection with the acquisition, we incurred a one-time write-off of acquired in-process technology of \$1.5 million based on an independent estimate of value.

INTEREST AND OTHER INCOME. Interest and other income increased to \$3.8 million in 1998 from \$2.9 million in 1997 and from \$1.6 million in 1996. The increase in

interest income in 1998 is a result of higher levels on cash equivalents and marketable securities in 1998 as compared with 1997 and 1996, as well as higher yields of financial investments.

Equity in income (loss) of equity method investees was \$125,000 in 1998, (\$706,000) in 1997 and (\$457,000) in 1996. In both 1997 and 1996 equity in losses of Aptel were included in our results of operations. In December 1997, Aptel's shareholders, including DSP Group, exchanged their shares in Aptel for shares of common stock of Nexus Telecommunications Systems Ltd. ("Nexus"), an Israeli company whose shares are registered and traded on the Nasdaq SmallCap Market. DSP Group's results of operations in 1998 do not include any equity gains (losses) pertaining to Aptel or Nexus.

The increase in equity in losses in 1997 compared to those in 1996 was due to our higher equity share in both Aptel and AudioCodes Ltd., an Israeli corporation. See Note 1 of the Notes to Consolidated Financial Statements for more information. Equity in income (loss) of equity method investees also included amortization of the excess of the purchase price over the 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, DSP Group entered into agreements with Rockwell International Inc. to license certain of DSP Group's TrueSpeech technologies and to settle all pending litigation between the companies. As part of the litigation settlement, DSP Group recorded a one time pre-tax gain of \$3.8 million, net of legal expenses.

GAIN ON SALE OF MARKETABLE EQUITY SECURITY. In April 1998, DSP Group sold all of its Nexus shares in a private transaction and realized a pre-tax one time gain on marketable equity securities of approximately \$1.1 million, which is included under "Other income (expense)" in our consolidated statements of income for 1998.

PROVISION FOR INCOME TAXES. The effective tax rate for the years ended December 31, 1998, 1997 and 1996 was 25%, 20% and 15%, respectively. The tax rate for 1998 is higher than 1997 due to previously unbenefited operating losses and tax credit carryforwards utilized in 1997 which are no longer available in 1998, offset by

increased foreign tax holiday benefits in 1998. The tax rate for 1997 is higher than 1996 due to decreased percentage benefits from the utilization of net operating loss carry forwards, offset slightly by increased percentage foreign tax holiday benefits and the recognition of previously unbenefited deferred tax assets.

DSP Group Ltd., DSP Group's subsidiary in Israel, has been granted "Approved Enterprise" status by the Israeli government according to four investment plans. The Approved Enterprise status allows for a tax holiday for a period of two to four years and a reduced corporate tax rate of 10% for an additional eight or six years, on the respective investment plans' proportionate share of taxable income. The tax benefits under these investment plans are scheduled to gradually expire starting from 2002 through 2009.

Management has assessed the need for a valuation allowance against deferred tax assets and has concluded that it is more likely than not that \$2.2 million deferred tax assets will be realized based on current levels of future taxable income and potentially refundable taxes.

LIQUIDITY AND CAPITAL RESOURCES

During 1998, DSP Group generated \$15.1 million of cash and cash equivalents from its operating activities as compared to \$18.6 million during 1997 and \$11.3 million in 1996. The decrease in 1998 of cash and cash equivalents as compared with that in 1997 occurred even though DSP Group experienced an increase in net income in 1998. The decrease in cash and cash equivalents was attributable primarily to the non-cash effects of recognizing deferred revenue and the cash used by the increase in accounts receivables and decrease in accounts payables, which in turn was partially offset by the decrease in our inventories and in our deferred income tax. The increase in cash and cash equivalents in 1997 as compared to 1996 was primarily due to the increase in net income from our operations and the increase in our deferred revenue.

We invest excess cash in marketable securities of varying maturity, depending on our projected cash needs for operations, capital expenditures and other business purposes. In 1998, DSP Group purchased \$60.0 million of investments classified as marketable securities, \$77.1 million in 1997 and \$32.2 million in 1996. In addition, DSP Group sold \$60.6 million of investments classified as marketable securities in 1998, \$49.3 million in 1997 and \$20.6 million in 1996. During 1998 and late 1997,

we extended the average maturity for our investments to a maximum of 24 months from the previous maximum of 18 months in early 1997. As a result, as of December 31, 1998 and December 31, 1997, a larger portion of our investments had been held for a period greater than one year as compared to the holding period of our investments as of December 31, 1996.

Our capital equipment purchases amounted to \$2.3 million in 1998, \$2.2 million in 1997 and \$836,000 in 1996 for computer hardware and software used in engineering development, engineering test equipment, leasehold improvements, vehicles, and furniture and fixtures. The acquisitions of capital equipment during 1998 were primarily for computer equipment, testing equipment and software for our research and development efforts during the year.

In 1996, DSP Group made an initial cash investment of \$2.0 million for approximately 40% of the equity interests in Aptel. In 1997, DSP Group invested an additional \$176,000 in convertible debentures of Aptel. Subsequently, in December 1997, Aptel's shareholders, including DSP Group, exchanged their shares in Aptel for shares in Nexus. In April 1998, DSP Group sold all of its Nexus shares in a private transaction for approximately \$1.3 million and realized a pre-tax one time gain on marketable equity securities of approximately \$1.1 million, which is included under "Other income (expense)" in our consolidated statements of income for the 1998.

In January 1998, DSP Group announced a stock repurchase program pursuant to which up to 1,000,000 shares of DSP Group common stock were to be acquired in the open market or in privately negotiated transactions. Accordingly, in 1998, we repurchased 814,000 shares of our common stock at an average purchase price of \$17.53 per share, for an aggregate purchase price of approximately \$14.3 million.

Cash received upon the exercise of employee stock options and through purchases pursuant to DSP Group's employee stock purchase plan in 1998 totaled \$1.2 million as compared with \$6.6 million in 1997 and \$495,000 in 1996. In addition, repayment of stockholders' notes receivable provided cash of \$434,000 in 1996.

At December 31, 1998, DSP Group's principal source of liquidity consisted of cash and cash equivalents totaling \$9.0 million and marketable securities of \$58.0

million. DSP Group's working capital at December 31, 1998 was \$68.7 million, an increase from the working capital of \$66.9 million at December 31, 1997.

We believe that our current cash, cash equivalent and marketable securities will be sufficient to meet our cash requirements through at least the next 12 months. In February 1999, our Board of Directors approved another stock repurchase program pursuant to which we may acquire up to 1,000,000 shares of DSP Group common stock in the open market or in privately negotiated transactions. Accordingly, we will use part of our available cash for this purpose. As part of DSP Group's business strategy, we occasionally evaluate potential acquisitions of businesses, products and technologies. Accordingly, a portion of our available cash may be used for the acquisition of complementary products or businesses. These potential transactions may require substantial capital resources, which may require us to seek additional debt or equity financing. However, we cannot provide assurance that we will consummate any such transactions.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK. It is DSP Group's policy not to enter into derivative financial instruments. DSP Group does not currently have any significant foreign currency exposure since it does not transact business in foreign currencies. Due to this, DSP Group did not have significant overall currency exposure at March 1, 1999.

FOREIGN CURRENCY RATE RISK. As nearly all of DSP Group's sales and expenses are denominated in U.S. Dollars, DSP Group has experienced only insignificant foreign exchange gains and losses to date, and does not expect to incur significant gains and losses in the next 12 months. DSP Group did not engage in foreign currency hedging activities during 1998.

EUROPEAN MONETARY UNION

Within Europe, the European Economic and Monetary Union (the "EMU") introduced a new currency, the euro, on January 1, 1999. During 2002, all EMU countries are expected to be operating with the euro as their single currency. Uncertainty exists as to the effect the euro currency will have on the marketplace. Additionally, all of the final rules and regulations have not yet

been defined and

finalized by the European Commission with regard to the euro currency. We are assessing the effect the euro formation will have on DSP Group's internal systems and the sale of DSP Group products. We expect to take appropriate actions based on the results of such assessment. We believe that the cost related to this issue will not be material to us and will not have a substantial effect on our financial condition and results of operations.

YEAR 2000 COMPLIANCE

DSP Group is aware of the issues associated with the programming code in existing computer systems as the Year 2000 approaches. The "Year 2000" problem is concerned with whether computer systems will properly recognize date sensitive information when the year changes to 2000. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail. The Year 2000 problem is pervasive and complex as the computer operation of virtually every company will be affected in some way.

Beginning in 1997, during 1998 and going forward in 1999, DSP Group is utilizing both internal and external resources to identify, correct or reprogram and test DSP Group's systems for Year 2000 readiness. We anticipate that all reprogramming efforts, including testing, will be completed by June 30, 1999. Our efforts include the evaluation of both information technology ("IT") and non-IT systems. Non-IT systems include systems or hardware containing embedded technology such as microcontrollers. To date the costs incurred by DSP Group with respect to this project are not material and we do not believe that future costs for the completion of this project will be material. However, if systems material to our operations have not been made Year 2000 ready by the completion of the project, the Year 2000 issue could have a material adverse effect on our financial statements. We have not developed a contingency plan to operate in the event that a noncompliant critical system is not remedied by January 1, 2000 and do not intend to do so.

Throughout 1998 and into 1999, we have been and continue to take steps to ensure that our products and services will continue to operate on and after January 1, 2000. We believe that DSP Group's products being shipped today are Year 2000 ready. In addition, to date, confirmations have been received from DSP Group's primary processing vendors that plans are being developed to address the processing

of transactions in the Year 2000. We also have been communicating with suppliers and other third parties that DSP Group does business with to coordinate Year 2000 readiness. The responses received to date indicate that such third parties are taking steps to address this concern.

Based upon the steps being taken to address this issue and the progress to date, we believe that Year 2000 readiness expenses will not have a material adverse effect on DSP Group's earnings. However, we cannot assure that Year 2000 problems will not occur with respect to DSP Group's computer systems. Furthermore, the Year 2000 problem may impact other entities with which we transact business, and we cannot predict the effect of the Year 2000 problem on such entities or the resulting effect on DSP Group. As a result, if preventative and/or corrective actions mainly by those which DSP Group does business with are not made in a timely manner, the Year 2000 issue could result in a failure of some of DSP Group's manufacturing operations, which would harm our business, financial condition and results of operations.

SUBSEQUENT EVENTS

SALE OF COMMON STOCK. On February 2, 1999, DSP Group announced that it had entered into a stock purchase agreement with Magnum Technologies, Ltd., an international investment fund ("Magnum"), in which DSP Group issued and sold 2,300,000 new shares of DSP Group common stock to Magnum. Based in part on Magnum's representations, the transaction was exempt from the registration requirements of the Securities Act of 1933 according to Section 4(2) of the Securities Act. These shares, representing 19.6% of DSP Group's outstanding common stock at the time of the transaction, were issued for a price of \$15 per share, or an aggregate of \$34.5 million in total net proceeds to DSP Group. As part of the agreement, Magnum may acquire additional shares of DSP

Group in the open market, but may not bring its total holdings to more than 35% of DSP Group's outstanding shares of common stock. Furthermore, Magnum has agreed not to sell any of the DSP Group shares of common stock it purchased without the prior written consent of DSP Group for a period of one year following the date of this transaction, and also to restrict its sales of the shares for an additional six-month period under Rule 144(e)(i) of the Securities

Act of 1933. Additionally, DSP Group has invited Magnum to appoint two new directors to the Board of Directors, bringing the total number of members of the Board of Directors to seven.

ACQUISITIONS. In the first quarter of 1999, DSP Group entered the wireless communication product market, which we believe to be synergistic with our existing markets. We acquired two integrated groups of engineers specializing in the design of integrated circuits for wireless communication. In addition, we acquired technology and products, including associated intellectual property, related to base band and RF for 900 Megahertz digital spread spectrum.

RISK FACTORS AFFECTING OPERATING RESULTS

The stockholders' letter and the discussion in this annual report that concerns DSP Group's future products, expenses, revenue, liquidity and cash needs as well as DSP Group's plans and strategies contain forward-looking statements concerning our future operations and financial results. These forward-looking statements are based on current expectations and we assume 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.

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY. Our quarterly results of operations may vary significantly in the future for a variety of reasons, including the following:

- fluctuations in volume and timing of product orders;
- timing of recognition of license fees;
- level of per unit royalties;
- changes in demand for our products due to seasonal customer buying patterns and other factors;
- timing of new product introductions by us or our customers, licensees or competitors;
- changes in the mix of products sold by us;
- fluctuations in the level of sales by OEMs and other vendors of products incorporating our products; and

- general economic conditions, including the changing economic conditions in Asia.

Each of the above factors is difficult to forecast and thus could have a material adverse effect on our business, financial condition and results of operations.

Through 1999, we expect that revenues from our DSP core designs and TrueSpeech algorithms 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 our operating results. Our per unit royalties from licenses are totally dependent upon the success of our OEM licensees in introducing products utilizing our technology and the success of those OEM products in the marketplace. Per unit royalties from TrueSpeech licensees have not been significant to date.

OUR AVERAGE SELLING PRICES CONTINUE TO DECLINE. We have experienced a decrease in the average selling prices of our TAD speech processors, but have 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. However, we cannot guarantee that our on-going efforts will be successful or that they will keep pace with the anticipated, continuing decline in average selling prices.

WE DEPEND ON THE DIGITAL TAD MARKET WHICH IS HIGHLY COMPETITIVE. Sales of TAD products comprise a substantial portion of our product sales. Any adverse change in the digital TAD market or in our ability to compete and maintain our position in that market would have a material adverse effect on our business, financial condition and results of operations. The digital TAD market and the markets for our products in general are extremely competitive and we expect that competition will only increase. Our existing and potential competitors in each of our 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 we do. It is possible that we may one day be unable to respond to increased price competition for TAD speech processors or other products through the introduction of new products or reductions of manufacturing costs. This inability would have a material adverse effect on our business, financial condition and

results of operations. Likewise, any significant delays by us in developing, manufacturing or shipping new or enhanced products would also have a material adverse effect on our business, financial condition and results of operations.

WE DEPEND ON REVENUES FROM A CURRENTLY UNSTABLE ASIAN MARKET. In 1997, we generated approximately \$19.9 million, or 39% of our total product sales, from sales to customers located in South Korea, Taiwan, Singapore and Hong Kong. However, in 1998, due to economic problems in some of these countries, most notably South Korea and Singapore, our product sales in this region decreased to \$10.9 million, or 22% of our total product sales. The decline in sales from Southeast Asia countries resulted in a decrease in our backlog, but was partially offset by increased orders from Japan. If this negative economic trend in the Asian markets continues, it may result in a further decrease of our backlog in 1999. We cannot provide assurance that continued negative economic development in Asia will not have a material adverse effect on our future operating performance.

WE DEPEND ON INDEPENDENT FOUNDRIES TO MANUFACTURE OUR INTEGRATED CIRCUIT PRODUCTS. All of our integrated circuit products are manufactured by independent foundries. While these foundries have been able to adequately meet the demands of our increasing business, we are and will continue to be dependent upon these foundries to achieve acceptable manufacturing yields, quality levels and costs, and to allocate to us a sufficient portion of foundry capacity to meet our needs in a timely manner. To meet our increased wafer requirements, we have added additional independent foundries to manufacture our TAD speech processors. Our revenues could be materially and adversely affected should any of these foundries fail to meet our request for products due to a shortage of production capacity, process difficulties, low yield rates or financial instability.

WE DEPEND ON INTERNATIONAL OPERATIONS, PARTICULARLY IN ISRAEL. We are subject to the risks of doing business internationally, including:

- unexpected changes in regulatory requirements;
- fluctuations in the exchange rate for the U.S. dollar;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws;
- political and economic instability; and
- changes in diplomatic and trade relationships.

In particular, our principal research and development facilities are

located in the State of Israel and, as a result, at December 31, 1998, 97 of our 120 employees were located in Israel, including all 66 of our research and development personnel. In addition, although DSP Group is incorporated in Delaware, a majority of our directors and executive officers are residents of Israel. Therefore, we are directly affected by the political, economic and military conditions to which Israel is subject.

Moreover, many of our expenses in Israel are paid in Israeli currency which subjects us to the risks of foreign currency fluctuations and to economic pressures resulting from Israel's generally high rate of inflation. The rate of inflation in Israel was 8.6% in 1998 and 7.0% in 1997. While substantially all of our sales and expenses are denominated in United States dollars, a portion of our expenses are denominated in Israeli shekels. Our primary expenses paid in Israeli currency are employee salaries and lease payments on our Israeli facilities. 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. We cannot provide assurance that currency fluctuations, changes in the rate of inflation in Israel or any of the other factors mentioned above will not have a material adverse effect on our business, financial condition and results of operations.

WE DEPEND ON OEMS AND THEIR SUPPLIERS TO OBTAIN REQUIRED COMPLEMENTARY COMPONENTS. Some of the raw materials, components and subassemblies included in the products manufactured by our OEM customers, which also incorporate our products, are obtained from a limited group of suppliers. Supply disruptions, shortages or termination of any of these sources could have an adverse effect on our business and results of operations due to the delay or discontinuance of orders for our products by customers until those necessary components are available.

WE DEPEND UPON THE ADOPTION OF INDUSTRY STANDARDS BASED ON TRUESPEECH. Our prospects are partially dependent upon the establishment of industry standards for digital speech compression based on TrueSpeech algorithms in the computer

telephony and Voice over IP markets. The development of industry standards utilizing TrueSpeech algorithms would create an opportunity for us 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.723.1, which is predominately composed of a TrueSpeech algorithm, as the standard speech compression technology for use in video conferencing over public telephone lines. In March 1997, the International Multimedia Teleconferencing Consortium, a nonprofit industry group, recommended the use of G.723.1 as the default audio coder for all voice transmissions over the Internet or for IP applications for H.323 conferencing products.

THERE ARE RISKS ASSOCIATED WITH OUR ACQUISITION STRATEGY. DSP Group has pursued, and will continue to pursue, growth opportunities through internal development and acquisition of complementary businesses, products and technologies. We are unable to predict whether or when any prospective acquisition will be completed. The process of integrating an acquired business may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management's attention. We cannot provide assurance that we will be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate acquired businesses into our operations, or expand into new markets. Once integrated, acquisitions may not achieve comparable levels of revenues, profitability or productivity as the existing business of DSP Group or otherwise perform as expected. The occurrence of any of these events could harm our business, financial condition or results of operations. Future acquisitions may require substantial capital resources, which may require us to seek additional debt or equity financing.

PROTECTION OF OUR INTELLECTUAL PROPERTY IS LIMITED; RISKS OF INFRINGEMENT OF RIGHTS OF OTHERS. As is typical in the semiconductor industry, we have been and may from time to time be notified of claims that we may be infringing patents or intellectual property rights owned by third parties. For example, AT&T has asserted that G.723.1, which is primarily composed of a TrueSpeech

algorithm, includes certain elements covered by patents held by AT&T and has requested that video conferencing manufacturers license the technology from AT&T. Other organizations including

Lucent Microelectronics, NTT and VoiceCraft have raised public claims that they also have patents related to the G.723.1 technology.

If it appears necessary or desirable, we may try to obtain licenses for those patents or intellectual property rights that we are allegedly infringing. Although holders of these type of intellectual property rights commonly offer these licenses, we cannot assure that licenses will be offered or that terms of any offered licenses will be acceptable to us. Our failure to obtain a license for key intellectual property rights from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacturing of products utilizing the technology. We believe that the ultimate resolution of these matters will not have a material adverse effect on our financial position, results of operations, or cash flows.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY YEAR 2000 READINESS ISSUES. During the next year, many software programs may not recognize calendar dates beginning in the Year 2000. This problem could force computers or machines that utilize date dependent software to either shut down or provide incorrect information. To address this problem, we have examined our computer and information systems and have contacted our primary processing vendors, suppliers and other third parties.

Although we believe that our products are Year 2000 compliant, undetected errors or defects may remain. Disruptions to our business or unexpected costs may arise because of undetected errors or defects in the technology used in our products. If we, or any of our key suppliers or customers, fail to mitigate internal and external Year 2000 risks, we may temporarily be unable to process transactions, manufacture products, send invoices or engage in similar normal business activities or we may experience a decline in sales, which could have a material adverse effect on our business, financial condition and results of operations.

OUR STOCK PRICE MAY BE VOLATILE. Announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results, changes in the general conditions of the highly dynamic industry in which we compete or the national economies in which we do business and other factors could cause the price of our common stock to fluctuate, perhaps substantially. In addition, in recent years the stock market has experienced extreme price fluctuations, which

have often been unrelated to the operating performance of affected companies.

These factors and fluctuations could have a material adverse effect on the market price of our common stock.

DSP Group, Inc.

Consolidated Statements of Income

| | YEARS ENDED DECEMBER 31, | | |
|--------------------------------|--|----------|----------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| | (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | | |
| Revenues: | | | |
| Product sales | \$49,252 | \$51,238 | \$41,290 |
| Licensing, royalties and other | 14,598 | 10,721 | 11,620 |
| | ----- | | |
| Total revenues | 63,850 | 61,959 | 52,910 |
| Costs of revenues: | | | |
| Product sales | 29,002 | 31,143 | 29,432 |
| Licensing, royalties and other | 426 | 1,169 | 1,096 |
| | ----- | | |
| Total cost of revenues | 29,428 | 32,312 | 30,528 |
| | ----- | | |

| | | | |
|--|-----------|-----------|----------|
| Gross profit | 34,422 | 29,647 | 22,382 |
| Operating expenses: | | | |
| Research and development | 10,181 | 8,420 | 8,481 |
| Sales and marketing | 5,222 | 4,934 | 4,429 |
| General and administrative | 4,632 | 4,505 | 5,669 |
| Unusual items | - | - | 1,529 |
| Total operating expenses | 20,035 | 17,859 | 20,108 |
| Operating income | 14,387 | 11,788 | 2,274 |
| Other income (expense): | | | |
| Interest and other income | 3,810 | 2,936 | 1,627 |
| Interest expense and other | (189) | (226) | (158) |
| Gain on sale of available-for-sale marketable securities | 1,086 | - | - |
| Gain on settlement of litigation, net of expenses | - | - | 3,750 |
| Equity in income (loss) of equity method investees, net of amortization of goodwill of \$105 in 1998, \$195 in 1997, and \$286 in 1996 | 125 | (706) | (457) |
| Income before provision for income taxes | 19,219 | 13,792 | 7,036 |
| Provision for income taxes | (4,804) | (2,758) | (1,057) |
| Net income | \$ 14,415 | \$ 11,034 | \$ 5,979 |
| Net income per share: | | | |
| Basic | \$ 1.48 | \$ 1.13 | \$ 0.63 |
| Diluted | \$ 1.44 | \$ 1.08 | \$ 0.62 |
| Shares used in per share computation: | | | |
| Basic | 9,768 | 9,736 | 9,510 |
| Diluted | 10,016 | 10,203 | 9,581 |

SEE ACCOMPANYING NOTES.

DSP Group, Inc.
Consolidated Balance Sheets

| | DECEMBER 31, | |
|---|--|-----------|
| | 1998 | 1997 |
| | ----- | |
| | (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 9,038 | \$ 7,325 |
| Marketable securities | 57,951 | 58,619 |
| Accounts receivable, less allowance for returns and doubtful accounts of \$304 in 1998 and \$293 in 1997 | 5,721 | 3,594 |
| Inventories | 2,182 | 4,116 |
| Deferred income taxes | 1,374 | 2,850 |
| Other accounts receivable | 1,608 | 1,441 |
| Total current assets | 77,874 | 77,945 |
| Property and equipment, net | 4,236 | 3,488 |
| Other investments, net of accumulated amortization | 1,834 | 2,935 |
| Other assets | 135 | 150 |
| Severance pay fund | 864 | 658 |
| Deferred income taxes | 848 | 650 |
| Total assets | \$ 85,791 | \$ 85,826 |
| | ----- | |

SEE ACCOMPANYING NOTES.

DSP Group, Inc.

| | | | | | | | | |
|---|--------|------|----------|-------|-------------|-----------|---------|----------|
| employee stock purchase plan | 28 | -- | 218 | -- | -- | -- | -- | 218 |
| Income tax benefit from stock options exercised | -- | -- | 1,037 | -- | -- | -- | -- | 1,037 |
| Balance at December 31, 1997 | 10,094 | 10 | 74,418 | -- | -- | (1,308) | -- | 74,170 |
| Net income | -- | -- | -- | -- | -- | 14,415 | -- | 14,415 |
| Comprehensive income | | | | | | | | |
| Unrealized gain on Marketable security | -- | -- | -- | -- | -- | -- | (1,050) | (1,050) |
| Total comprehensive income | -- | -- | -- | -- | -- | -- | -- | 13,365 |
| Purchase of Treasury Stock | (814) | (1) | -- | -- | (14,273) | -- | -- | (14,274) |
| Exercise of Common Stock options by employees | 94 | -- | -- | -- | 1,821 | (908) | -- | 913 |
| Sale of Common Stock under employee stock purchase plan | 32 | -- | -- | -- | 399 | (70) | -- | 329 |
| Income tax benefit from stock options exercised | -- | -- | 1,192 | -- | -- | -- | -- | 1,192 |
| Balance at December 31, 1998 | 9,406 | \$ 9 | \$75,610 | \$ -- | \$ (12,053) | \$ 12,129 | \$ -- | \$75,695 |

DSP Group, Inc.

Consolidated Statements of Cash Flows

| | YEARS ENDED DECEMBER 31, | | |
|---|--------------------------|-----------|----------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| | (IN THOUSANDS) | | |
| OPERATING ACTIVITIES | | | |
| Net income | \$ 14,415 | \$ 11,034 | \$ 5,979 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 1,572 | 1,797 | 1,443 |
| Amortization of software development costs | - | 322 | 185 |
| Deferred revenue | (2,324) | 2,360 | (50) |
| Deferred income tax | 2,470 | (1,459) | 1,169 |
| Gain on sale of marketable equity security | (1,086) | - | - |
| Gain on write off of deferred rent | - | - | (380) |
| Acquired research and development from related party | - | - | 1,529 |
| Equity in (income) loss of equity method investees net of amortization | (125) | 706 | 457 |
| Write down/write off of assets | - | - | 290 |
| Write off of capitalized software development cost | - | - | 31 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (2,127) | 1,267 | 2,628 |
| Accounts and notes receivable from related parties | - | - | 640 |
| Inventories | 1,934 | (1,159) | 43 |
| Other current assets | (167) | (84) | (481) |
| Other assets | 15 | (84) | (14) |
| Accounts payable | (959) | 1,891 | (1,009) |
| Accrued compensation and benefits | 384 | 432 | (152) |
| Severance pay - net | 31 | - | - |
| Income taxes payable | 218 | 783 | (609) |
| Accrued royalties | 476 | (5) | (371) |
| Accrued expenses and other | 408 | 779 | 16 |
| Net cash provided by operating activities | \$15,135 | \$18,580 | \$11,344 |

SEE ACCOMPANYING NOTES.

DSP Group, Inc.

Consolidated Statements of Cash Flows (continued)

| | YEARS ENDED DECEMBER 31, | | |
|--|--------------------------|-------------|------------|
| | 1998 | 1997 | 1996 |
| | ----- | | |
| | (IN THOUSANDS) | | |
| INVESTING ACTIVITIES | | | |
| Purchase of marketable securities | \$(59,980) | \$ (77,135) | \$(32,217) |
| Sale of marketable securities | 60,648 | 49,278 | 20,604 |
| Purchases of equipment | (2,320) | (2,160) | (836) |
| Sale of equipment | - | 166 | - |
| Investment in an investee | - | (176) | (2,158) |
| Realization of investment in an investee | 1,262 | - | - |
| Capitalized software development costs | - | - | (173) |
| Net cash used in investing activities | (390) | (30,027) | (14,780) |

| FINANCING ACTIVITIES | | | |
|--|----------|----------|-----------|
| Sale of Common Stock for cash upon exercise of options, warrants, and employee stock purchase plan | 1,240 | 6,600 | 495 |
| Repayment of stockholders' notes receivable | - | - | 434 |
| Purchase of treasury stock | (14,273) | - | - |
| Net cash provided by (used in) financing activities | (13,033) | 6,600 | 929 |
| Increase (decrease) in cash and cash equivalents | 1,713 | (4,847) | (2,507) |
| Cash and cash equivalents at beginning of year | 7,325 | 12,172 | 14,679 |
| Cash and cash equivalents at end of year | \$ 9,038 | \$ 7,325 | \$ 12,172 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

| | | | |
|----------------------------------|----------|----------|--------|
| Cash paid during the period for: | | | |
| Interest expense | \$ - | \$ 6 | \$ 17 |
| Income taxes | \$ 1,530 | \$ 3,148 | \$ 372 |

SEE ACCOMPANYING NOTES.

DSP Group, Inc.

Notes to Consolidated Financial Statements

December 31, 1998

NOTE 1: GENERAL

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 Group Ltd. ("DSP Group Israel"), an Israeli corporation primarily engaged in research, development, marketing, sales, technical support and certain general and administrative functions; Nihon DSP K.K. ("DSP Japan"), a Japanese corporation primarily engaged in marketing and technical support activities; and DSP Group Europe SARL, a French corporation primarily engaged in marketing and technical support activities.

Revenues derived from the Company's largest reseller Tomen Electronics represented 45%, 33% and 17% of the Company's revenues for 1998, 1997 and 1996, respectively. Revenues derived from sales to another customer represented 11% of the Company's revenues in 1996.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States.

CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly 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.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

REVENUE RECOGNITION

PRODUCT SALES

Product sales of speech processors for digital telephone answering devices, computer telephony and other products are 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 costs of warranty when specific problems are identified.

LICENSING AND ROYALTY REVENUES

Revenues from software license agreements are recognized upon delivery of the software: (1) when collection is probable; (2) all license payments are due within one year; (3) the license fee is otherwise fixed and determinable; (4) vendor specific evidence exists to allocate the total fee to the undelivered elements of the arrangements; and (5) persuasive evidence of an arrangement exists. Revenues from maintenance contracts are recognized ratably over the term of the agreement. Costs related to insignificant obligations, primarily telephone support, are accrued upon shipment and are included in cost of revenues. 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.

DEFERRED REVENUE

In the first quarter of 1998, the Company recorded approximately \$2.2 million of revenue and approximately \$1.2 million of related inventory cost, which had been previously deferred at December 31, 1997, as the Company had not yet finalized testing on a certain TAD chip shipped to a customer during 1997.

EQUIPMENT AND LEASEHOLD IMPROVEMENTS

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

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

INVENTORIES

Inventories are stated at the lower of cost or market. Inventories are composed of the following (IN THOUSANDS):

| | DECEMBER 31, | |
|-----------------|----------------|----------------|
| | 1998 | 1997 |
| Work-in-process | \$ -- | \$ 16 |
| Finished goods | 2,182 | 4,100 |
| | <u>\$2,182</u> | <u>\$4,116</u> |

OTHER INVESTMENTS

Other investments are comprised of (in thousands):

DECEMBER 31,
1998 1997

Equity method investments:

| | | |
|---|----------|----------|
| Investment in AudioCodes Ltd., net of accumulated amortization of \$891 in 1998 and \$876 in 1997 | \$ 1,834 | \$ 1,709 |
|---|----------|----------|

Cost method investments:

| | | |
|---|----------|----------|
| Investment in Nexus Telecommunications Systems Ltd., at fair value (1997 - cost basis of \$176) | - | 1,226 |
| | ----- | ----- |
| | \$ 1,834 | \$ 2,935 |
| | ----- | ----- |

AUDIOCODES, LTD.

AudioCodes, Ltd. ("AudioCodes") is an Israeli corporation primarily engaged in design, research, development, manufacturing and marketing hardware and software products that enable simultaneous transmission of voice and data over networks such as Internet, ATM and Frame Relay. 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 has an option under certain conditions to purchase up to an additional 5% of the outstanding stock of AudioCodes.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

The Company accounts for its ownership in AudioCodes using the equity method. The Company's original investment in AudioCodes included the excess of purchase price over net assets acquired (approximately \$1,907,000 at the date of purchase), which was attributed to developed technology to be amortized over seven years. The private placement by AudioCodes in July 1997 was at a price per share greater than the Company's then current investment in AudioCodes. As a result, even though the Company's ownership interest decreased from 35% to 29%, the Company's proportionate share of the net assets of AudioCodes increased from \$816,000 to \$1,481,000 at the date of the private placement. This increase in the Company's proportionate share of the net assets of AudioCodes reduced the remaining unamortized excess of purchase price over net assets acquired from \$1,080,000 to \$415,000 as of the date of the private placement.

The Company's equity in the net income (loss) of AudioCodes was \$230,000 in 1998, (\$103,000) in 1997, and \$36,000 in 1996. As of December 31, 1998, the difference between the investment in AudioCodes and the Company's proportionate share of net assets is \$251,000, primarily related to the remaining unamortized portion of the excess of purchase price over net assets.

APTEL LTD. AND NEXUS TELECOMMUNICATIONS SYSTEMS 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 Israel. 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 accounted for its investment in Aptel using the equity method. The Company's equity in the net losses of Aptel, including amortization of related intangibles, was \$408,000 in 1997 and \$221,000 in 1996. As of June 30, 1997, the Company had fully written-off its investment in Aptel.

In December 1997, Aptel's shareholders, including the Company exchanged their shares in Aptel for ordinary shares of Nexus Telecommunications Systems Ltd. ("Nexus"). Nexus is an Israeli company whose shares are registered and traded on the Nasdaq SmallCap Market under the symbol NXUSF. In October 1997, the Company invested \$176,000 in a convertible debenture in Aptel which was converted into ordinary shares of Aptel prior to the closing of the Nexus transaction. The Company received approximately 297,000 ordinary shares of Nexus in the exchange transaction amounting

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

to approximately 3% ownership interest in Nexus. The Company's basis in the Nexus stock received is \$176,000 and the Company accounted for the investment using the cost method. At December 31, 1997, the Company's investment in Nexus was presented in the Company's consolidated balance sheet at the market value of \$1,226,000, with the unrealized gain of \$1,050,000 recorded as other comprehensive income, as a separate component of stockholder's equity. In April 1998, the Company sold all of its Nexus shares in a private transaction and realized a pre-tax gain on marketable equity securities of approximately \$1.1 million, which is included under "Other income (expense)" in the Company's consolidated statements of income for 1998.

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.

NET INCOME PER SHARE

Basic net income per share is computed based on the weighted average number of shares of common stock outstanding during the period. For the same periods, diluted net income per share further includes the effect of dilutive stock options outstanding during the year, all in accordance with the Financial Accounting Standards Board issued Statement No. 128, "Earnings per Share" ("SFAS 128"). The following table sets forth the computation of basic and diluted net income per share (in thousands except per share amounts):

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

| | 1998 | 1997 | 1996 |
|--|-----------|-----------|----------|
| | ----- | ----- | ----- |
| Numerator: | | | |
| Net Income | \$ 14,415 | \$ 11,034 | \$ 5,979 |
| | ----- | ----- | ----- |
| Denominator: | | | |
| Weighted average number of shares of common stock outstanding during the period used to compute basic income per share..... | 9,768 | 9,736 | 9,510 |
| Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase treasury stock)..... | 248 | 467 | 71 |
| | ----- | ----- | ----- |
| Weighted average number of shares of common stock used to compute diluted income per share..... | 10,016 | 10,203 | 9,581 |
| | ----- | ----- | ----- |
| Basic net income per share..... | \$1.48 | \$1.13 | \$0.63 |
| | ----- | ----- | ----- |
| Diluted net income per share..... | \$1.44 | \$1.08 | \$0.62 |
| | ----- | ----- | ----- |

Options outstanding to purchase approximately 657,000, 210,000 and 1,067,000 of common stock for the years ended December 31, 1998, 1997 and 1996, respectively, were not included in the computation of diluted net income per share, because option exercise prices were greater than the average market price of the common shares and therefore, the effect would be antidilutive.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose 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

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

type of investment. The majority of the Company's sales of products 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 DSP Core microprocessor architectures and speech compression technology. No collateral is required from the Company's customers; however, some of the customers pay using letters of credit. Write-offs for bad debts have not been significant to date.

CONCENTRATION OF OTHER RISKS

Sales of telephone answering device ("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 1999, the Company expects that revenues from its DSP Core 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") licensees in introducing these products and the success of such products in the marketplace.

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, low yield rates or financial instability. 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.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

CASH EQUIVALENTS

The Company considers all highly liquid investments which are readily convertible to cash with an original maturity of three months or less when purchased to be cash equivalents. The carrying amount of cash and cash equivalents as of December 31, 1998 and 1997 approximates fair value.

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" ("SFAS 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 interest and other income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in interest and other 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, 1998 and 1997 (in thousands):

| | AMORTIZED COST | |
|--|----------------|----------|
| | 1998 | 1997 |
| Obligations of states and political subdivisions | \$25,290 | \$6,002 |
| Corporate obligations | 33,218 | 53,270 |
| | ----- | ----- |
| | \$58,508 | \$59,272 |
| | ----- | ----- |
| Amounts included in marketable securities | \$57,951 | \$58,619 |
| Amounts included in cash and cash equivalents | 557 | 653 |
| | ----- | ----- |
| | \$58,508 | \$59,272 |
| | ----- | ----- |

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

At December 31, 1998 and 1997, 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 1998, 1997, and 1996 were not significant. The amortized cost of available-for-sale debt and securities at December 31, 1998, by contractual maturities, are shown below (IN THOUSANDS):

| | AMORTIZED COST |
|-------------|----------------|
| | ----- |
| Due in 1999 | \$ 2,028 |
| Due in 2000 | 55,923 |
| | ----- |
| | \$ 57,951 |
| | ----- |

SEVERANCE PAY

The Company's subsidiary, DSP Group Israel, has liability for severance pay pursuant to Israeli law, which is fully provided by an accrual. The majority of the liability is funded through insurance policies. The cash value of these policies is recorded as an asset in the Company's consolidated balance

sheets.

Severance expenses for the years ended December 31, 1998, 1997 and 1996, were approximately \$367,000, \$135,000 and \$95,000, respectively.

GAIN ON SETTLEMENT OF LITIGATION

In October 1996, the Company entered into agreements with Rockwell International, Inc. to license certain of the Company's TrueSpeech technologies and to settle all pending litigation between the companies. In connection with the litigation settlement in

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

1996, the Company recorded in other income a one time pre-tax gain on settlement of litigation, net of expenses of \$3.8 million.

ACCOUNTING FOR 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" ("SFAS 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. See pro forma disclosures of applying SFAS 123 in Note 4 below.

COMPREHENSIVE INCOME

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"), which establishes new rules for the reporting and display of comprehensive income and its components. SFAS 130 requires unrealized gains or losses on the Company's available for sale securities, which prior to adoption were reported separately in stockholders' equity to be included in other comprehensive income. Prior year financial statements have been reclassified to conform to the requirements of SFAS 130. The adoption of this SFAS had no impact on the company's results of operations or financial position.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). This Statement establishes accounting and reporting standards requiring that every derivative instrument, including certain derivative instruments embedded in other contracts, be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement also requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the respective

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of any transactions that receive hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999 and cannot be applied retroactively. The Company does not expect the impact of this new Statement on the Company's consolidated balance sheets or results of operations to be material.

NOTE 3. PROPERTY AND EQUIPMENT

Composition of assets, grouped by major classifications, is as follows (IN THOUSANDS):

| | DECEMBER 31, | |
|------------------------------------|--------------|----------|
| | 1998 | 1997 |
| Computers and peripheral equipment | \$ 8,209 | \$ 6,341 |
| Office furniture and equipment | 808 | 774 |
| Motor vehicles | 933 | 654 |
| Leasehold improvements | 1,380 | 1,241 |
| | ----- | ----- |
| | 11,330 | 9,010 |
| Less accumulated depreciation | 7,094 | 5,522 |
| | ----- | ----- |
| | \$ 4,236 | \$ 3,488 |
| | ----- | ----- |

NOTE 4. STOCKHOLDERS' EQUITY

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)

DIVIDEND POLICY

At December 31, 1998, the Company had retained earnings of approximately \$13.1 million. The Company has never paid dividends on its Common Stock and presently intends to follow a policy of retaining any earnings for reinvestment in its business.

SHARE REPURCHASE PROGRAM

In 1998, the Company commenced a program to buy an aggregate of up to 1,000,000 shares of Common Stock of the Company. As of December 31, 1998, the Company had acquired 814,000 shares for an aggregate purchase price of \$14.3 million. Such repurchases of ordinary shares are accounted for as treasury stock, and result in a reduction of stockholders' equity. When treasury shares are reissued, the Company charges the excess of the repurchase cost over issuance price using the weighted average method to retain earnings.

STOCK PURCHASE PLAN AND STOCK OPTION PLANS

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 non-qualified 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 3,800,000 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 up to seven years after the date of grant.

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 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, following certain amendments in 1996 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 director who subsequently becomes a member of the Board of Directors shall

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

automatically be granted an option to purchase 15,000 shares (the First Option). Additionally, each outside director shall automatically be granted an option to purchase 5,000 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.

Options granted under the Directors' Plan generally have a term of ten years. The First Option is 25% exercisable 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).

1993 ISRAELI PLAN

In 1993, the Company adopted the 1993 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.

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 the Company's Common Stock. Officers and directors of the Company are excluded from participating under the 1998 Plan. The 1998 Plan expires in 2008 and currently provides for the purchase of up to 950,000 shares of the Company's Common Stock.

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

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

Options under the 1998 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 1998 Plan expire up to seven years after the date of grant.

A summary of activity under the 1991 Plan, the 1993 Israeli Plan, the Directors' Plan, and the 1998 Plan is as follows (SHARES IN THOUSANDS):

| | SHARES AVAILABLE FOR GRANT | OPTIONS OUTSTANDING | |
|------------------------------|----------------------------------|---------------------------|---------------------------------------|
| | | SHARES UNDER OPTION | WEIGHTED AVERAGE EXERCISE PRICE |
| BALANCE AT DECEMBER 31, 1995 | 236 | 1,062 | \$ - |
| Authorized | 875 | - | \$ - |
| Granted | (990) | 990 | \$ 9.61 |
| Exercised | - | (77) | \$ 3.71 |
| Canceled | 500 | (500) | \$13.00 |
| BALANCE AT DECEMBER 31, 1996 | 621 | 1,475 | \$10.94 |

| | SHARES AVAILABLE FOR GRANT | OPTIONS OUTSTANDING | |
|------------------------------|----------------------------------|---------------------------|---------------------------------------|
| | | SHARES UNDER OPTION | WEIGHTED AVERAGE EXERCISE PRICE |
| Authorized | - | - | \$ - |
| Granted | (797) | 797 | \$21.67 |
| Exercised | - | (526) | \$12.12 |
| Canceled | 429 | (429) | \$11.18 |
| BALANCE AT DECEMBER 31, 1997 | 253 | 1,317 | \$16.87 |
| Authorized | 1,950 | - | \$ - |
| Granted | (812) | 812 | \$18.54 |
| Exercised | - | (94) | \$ 9.95 |
| Canceled | (136) | (136) | \$13.59 |
| BALANCE AT DECEMBER 31, 1998 | 1,527 | 1,899 | \$18.17 |

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

A summary of the average price per share and the number of options exercisable for the years 1998, 1997 and 1996, is as follows:

| | 1998 | 1997 | 1996 |
|--|------|------|------|
| Number of options exercisable as of December 31, (OPTIONS IN THOUSANDS) | 469 | 375 | 144 |

 Weighted average fair
 value of options
 granted during the year \$ 18.54 \$ 21.67 \$ 9.61

A summary of the Company's stock option activity and related information as of December 31, 1998, is as follows:

| RANGE OF EXERCISE PRICES | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|--------------------------|-------------------------------|---|---------------------------------|-------------------------------|---------------------------------|
| | NUMBER OF OPTIONS OUTSTANDING | WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE | WEIGHTED-AVERAGE EXERCISE PRICE | NUMBER OF OPTIONS EXERCISABLE | WEIGHTED AVERAGE EXERCISE PRICE |
| \$ 7.63 - \$11.75 | 393,440 | 3.55 Years | 9.25 | 140,916 | 9.54 |
| \$12.00 - \$18.56 | 533,299 | 3.89 Years | 16.78 | 127,651 | 15.13 |
| \$18.81 - \$18.88 | 294,000 | 4.58 Years | 18.87 | 0 | 0 |
| \$19.25 - \$24.25 | 347,300 | 4.23 Years | 21.47 | 73,133 | 22.44 |
| \$25.38 - \$34.38 | 331,000 | 3.69 Years | 26.99 | 127,311 | 26.79 |
| | 1,899,039 | 3.95 Years | \$18.17 | 469,011 | \$17.76 |

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 amount of 350,000 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

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

32,000, 28,000 and 24,000 shares issued under the Purchase Plan in 1998, 1997 and 1996, respectively.

COMMON STOCK RESERVED FOR FUTURE ISSUANCE

Shares of Common Stock of the Company reserved for future issuance at December 31, 1998, are as follows (in thousands):

| | |
|------------------------------|-------|
| Employee Stock Purchase Plan | 250 |
| Stock Options | 3,426 |
| Undesignated Preferred Stock | 5,000 |
| | ----- |
| | 8,676 |
| | ----- |
| | ----- |

STOCK BASED COMPENSATION

Pro forma information regarding net income and earnings per share is required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), which requires the use of option valuation models that were not developed for use in valuing employee stock options. For example, 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.

The fair value of the Company's employee stock 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 5.02%, 6.15% and 6.10% for 1998, 1997 and 1996, respectively; a dividend yield of 0.0% for each of those years; a volatility factor of the expected market price of the Company's Common Stock of 0.77 for 1998, 0.70 for 1997 and 0.55 for 1996; and a weighted-average expected life of the option of 3.0 years for 1998, 3.1 years for 1997, and 3.6 years for 1996. The weighed average net fair value of options granted in 1998, 1997 and 1996 was \$9.65, \$9.90 and \$4.53 per share, respectively.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

The Company does not recognize compensation cost related to employee stock purchase rights under the Employee Stock Purchase Plan. To comply with the pro forma reporting requirements of SFAS 123, compensation cost is estimated for the fair value of the employees' stock purchase rights using the Black-Scholes model with the following assumptions for those rights granted in 1998, 1997 and 1996; dividend yield of 0.0%; an expected life ranging up to 0.5 years; expected volatility factor of 0.71 in 1998, 0.75 in 1997 and 0.5 in 1996; and a risk free interest rate of 4.84% in 1998, 5.49% in 1997 and 5.72% in 1996. The weighted average fair value of those purchase rights granted in January 1998, July 1998, January 1997, July 1997, January 1996 and July 1996 were \$10.70, \$9.57, \$2.45, \$8.21, \$1.31 and \$1.17, respectively.

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 SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

| | 1998 | 1997 | 1996 |
|--------------------------------------|---------------------------------------|----------|----------|
| | ----- | | |
| | (In thousands, except per share data) | | |
| Pro forma net income | \$ 10,428 | \$ 8,485 | \$ 2,843 |
| Pro forma basic earnings per share | \$ 1.07 | \$ 0.87 | \$ 0.30 |
| Pro forma diluted earnings per share | \$ 1.07 | \$ 0.85 | \$ 0.30 |

COMMON STOCK REPURCHASE

In 1998, the Company repurchased 814,000 shares of its Common Stock at an average purchase price of \$17.53 per share, for an aggregate purchase price of approximately \$14.3 million. The Company accounts for the investment in its shares according to the treasury stock method.

NOTE 5. INDUSTRY SEGMENT REPORTING

The Company operates in one business segment approach, principally the development of affordable, high performance, cost effective DSP-based software, integrated circuits, and circuit boards.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

Operations outside the United States include research, development, sales, marketing 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 (IN THOUSANDS):

| | 1998 | 1997 | 1996 |
|----------------------------------|----------|----------|----------|
| | ----- | ----- | ----- |
| Sales to unaffiliated customers: | | | |
| United States | \$31,436 | \$57,364 | \$51,883 |
| Israel | 32,414 | 4,595 | 1,027 |
| | ----- | ----- | ----- |
| | \$63,850 | \$61,959 | \$52,910 |
| | ----- | ----- | ----- |
| Revenues: | | | |
| United States | \$ 3,821 | 4,688 | 4,833 |
| Export: | | | |
| Japan | 35,711 | 23,402 | 11,390 |
| Europe | 10,591 | 10,357 | 10,853 |
| Asia | 12,616 | 21,644 | 24,087 |
| Israel | 1,111 | 1,868 | 1,747 |
| | ----- | ----- | ----- |
| | \$63,850 | \$61,959 | \$52,910 |
| | ----- | ----- | ----- |
| Long-lived assets: | | | |
| United States | \$ 2,085 | \$ 2,252 | \$ 2,796 |
| Israel | 4,783 | 4,751 | 3,409 |
| Other | 66 | 77 | 70 |
| | ----- | ----- | ----- |
| | \$ 6,934 | \$ 7,080 | \$ 6,275 |
| | ----- | ----- | ----- |

NOTE 6. COMMITMENTS AND CONTINGENCIES

COMMITMENTS

The Company leases certain equipment and facilities under noncancelable operating leases. The Company has significant leased facilities in Herzelia Pituach, Israel and in Santa Clara, California. In 1996, the Company negotiated the assignment of certain of its Santa Clara facility use obligations to another company (the "Assignee"). The Company received payments from the Assignee in the Santa Clara facility, of \$322,000 in both 1998

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

and 1997 and will receive \$322,000 in 1999, and \$295,000 in 2000. 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. In August 1997, the Company entered into a new lease for its Israel facilities in Herzelia Pituach. The lease agreement is effective until May 2002. In September 1998, the Company entered into a new lease for more office space at its Israel facilities in Herzelia Pituach. The lease agreement for the additional space is effective until November 2003.

At December 31, 1998, the Company is required to make the following minimum lease payments, as revised to reflect the assignment of the lease and the sublease of the new space by the Company in the same buildings as described above (IN THOUSANDS).

| Year | Amount |
|------|--------|
| ---- | ----- |

| | |
|------|---------|
| 1999 | \$ 596 |
| 2000 | 263 |
| 2001 | 564 |
| 2002 | 291 |
| 2003 | 95 |
| | ----- |
| | \$1,809 |
| | ----- |
| | ----- |

Total rental expense for all leases was approximately \$545,000 (net of sublease income of \$365,000), \$778,000 (net of sublease income of \$469,000), \$334,000 (net of sublease income of \$546,000, and a gain of \$380,000 on write-off of deferred rent), for the years ended December 31, 1998, 1997, and 1996, respectively.

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.

On February 12, 1997, BEKA Electronic GmbH ("BEKA") commenced an action in the United States District Court for the Northern District of California against DSP Group. The action alleges breach of contract, breach of implied covenant of good faith and fair dealing and requests an accounting by us in connection with our termination of the Sales Representative Agreement between BEKA and us. The complaint seeks an unspecified amount of damages. The parties completed non-binding mediation in May 1998, but were unable to settle the case. Discovery in the case has been completed. Trial has been set for May 11, 1999. DSP Group believes the lawsuit to be without merit and intends to defend itself vigorously.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

NOTE 7. INCOME TAXES

The provision for income taxes is as follows (IN THOUSANDS):

| | 1998 | 1997 | 1996 |
|----------------------------|----------|----------|----------|
| | ----- | ----- | ----- |
| Federal taxes: | | | |
| Current | \$ 2,751 | \$ 3,166 | \$ (180) |
| Deferred | 1,181 | (1,301) | 1,099 |
| | ----- | ----- | ----- |
| | 3,932 | 1,865 | 919 |
| State taxes: | | | |
| Current | 216 | 337 | 3 |
| Deferred | 97 | (158) | 70 |
| | ----- | ----- | ----- |
| | 313 | 179 | 73 |
| Foreign taxes: | | | |
| Current | 559 | 714 | 65 |
| | ----- | ----- | ----- |
| Provision for income taxes | \$ 4,804 | \$ 2,758 | \$ 1,057 |
| | ----- | ----- | ----- |
| | ----- | ----- | ----- |

The tax benefits associated with the exercise of stock options reduced taxes currently payable by \$1,192,000 in 1998 and \$1,037,000 in 1997. Such benefits were credited to paid in capital when realized.

Pretax income (loss) from foreign operations was \$7,330,000, \$3,495,000 and \$1,061,000 in 1998, 1997 and 1996, respectively (exclusive of an in-process technology write-off of \$1,529,000 in 1996).

Unremitted foreign earnings that are considered to be permanently invested outside of the U.S., and on which no deferred taxes have been provided, amount to approximately \$9,600,000 at December 31, 1998. If such amounts were remitted, the Company would be subject to U.S. income taxes (subject to an adjustment for foreign tax credits) and additional Israeli corporate income and withholding taxes of approximately \$2,300,000.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

A reconciliation between the Company's effective tax rate and the U.S. statutory rate (IN THOUSANDS):

| | YEARS ENDED DECEMBER 31, | | |
|--|--------------------------|----------|----------|
| | 1998 | 1997 | 1996 |
| Tax at U.S. statutory rate | \$ 6,534 | \$ 4,827 | \$ 2,396 |
| State taxes, net of federal benefit | 207 | 116 | 3 |
| Operating losses utilized | - | (1,160) | (1,169) |
| Tax exempt interest income | - | (26) | (422) |
| Foreign income taxed at rates other than U.S. rate | (1,806) | (813) | (306) |
| Research and development expensed upon acquisition | - | - | 520 |
| Tax credits utilized | (264) | (480) | - |
| Nondeductible losses and expenses of investees | - | 247 | 92 |
| Other individually immaterial items | 133 | 47 | (57) |
| | \$ 4,804 | \$ 2,758 | \$ 1,057 |

As of December 31, 1998, the Company had federal net operating loss and tax credit carryforwards of approximately \$1,132,000 and \$108,000, respectively. These carryforwards will expire in years 2007 through 2008, if not utilized.

Due to the change in ownership provisions of the Tax Reform Act of 1986, the Company's federal net operating loss carryforwards are subject to an annual limitation of approximately \$3,300,000 per year.

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, 1998 and 1997 are as follows (IN THOUSANDS):

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

| | 1998 | 1997 |
|--------------------------|--------|--------|
| Deferred tax assets: | | |
| Tax credit carryforwards | \$ 108 | \$ 530 |

| | | |
|--------------------------------------|----------|----------|
| Net operating loss carryforwards | 385 | 1,550 |
| Capitalized research and development | 222 | 330 |
| Reserves and accruals | 690 | 1,730 |
| Other | 817 | 610 |
| | ----- | ----- |
| Total deferred tax assets | \$ 2,222 | 4,750 |
| Valuation allowance | -- | (1,250) |
| | ----- | ----- |
| Net deferred tax assets | \$ 2,222 | \$ 3,500 |
| | ----- | ----- |

Management believes that the deferred tax assets will be realized based on current levels of future taxable income and potentially refundable taxes. The valuation allowance decreased by \$1,250,000, \$2,446,000 and \$189,000 in 1998, 1997 and 1996, respectively.

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

According to the provisions of such Israeli law, DSP Group Israel has chosen to enjoy "Alternative plans 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% for an additional period of eight or six years, respectively. The tax benefits under these investment plans are scheduled to gradually expire starting from 2002 through 2009.

DSP Group Israel's first and second plans, which were completed and commenced operation in 1992 and 1996, respectively, are tax exempt for four years and are entitled to a reduced corporate tax rate of 10% for an additional period of six years. The third and fourth plans were approved in 1996 and 1998, respectively. They entitle DSP Group Israel to a corporate tax exemption for a period of two years for each plan and to a reduced corporate tax rate of 10% for an additional period of eight years.

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

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

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 the retained tax exempt income is distributed in a manner other than in the complete liquidation of DSP Group Israel, it would be taxed at the corporate tax rate applicable to such profits as if DSP Group Israel had not chosen the alternative tax benefits and an income tax liability would be incurred of approximately \$1,859 as of December 31, 1998.

Through December 31, 1998, DSP Group Israel has met all the conditions required under the approvals.

Should DSP Group Israel fail to meet such conditions in the future, however, 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.

Income 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.

NOTE 8. RELATED PARTY TRANSACTIONS

In 1993, the Company entered into a development and licensing agreement with AudioCodes (SEE NOTE 2 OTHER INVESTMENTS). 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 service fee and additional royalty fees of 15% to 50% of the net revenue and 3% to 10% of the gross margin realized from the sale of the technology incorporated in the Company's products. In 1998, 1997 and 1996 the Company recorded the following (IN THOUSANDS):

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

| RELATED PARTY TRANSACTIONS | 1998 | 1997 | 1996 |
|----------------------------|------|-------|-------|
| REVENUES: | | | |
| ----- | | | |
| Product sales | 944 | 1,542 | 1,644 |
| Licensing | 82 | 206 | 65 |
| COST OF REVENUES: | | | |
| ----- | | | |
| Cost of products | 384 | 291 | -- |
| Cost of licensing | 160 | 268 | 355 |
| OPERATING EXPENSES: | | | |
| ----- | | | |
| Research and development | 345 | 340 | 269 |

NOTE 9. SUBSEQUENT EVENTS

On February 2, 1999, the Company announced that it had entered into a stock purchase agreement with Magnum Technologies, Ltd., an international investment fund ("Magnum"), in which the Company issued and sold 2,300,000 new shares of its Common Stock to Magnum, which represented approximately 20% of the Company's outstanding Common Stock at the time of the transaction, for \$15 per share, or an aggregate of \$34.5 million in total gross proceeds to the Company. As part of the agreement, Magnum may acquire additional shares of the Company's Common Stock in the open market, but may not bring its total holdings to more than 35% of the Company's outstanding shares of Common Stock.

In February 1999, the Board of Directors authorized the Company's plan to repurchase up to 1,000,000 shares of its Common Stock from time to time on the open-market or in privately negotiated transactions.

DSP Group, Inc.

Notes to Consolidated Financial Statements (continued)

Report of 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, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of three years in the period ended December 31, 1998. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of DSP Group, Inc. at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Palo Alto, California
January 25, 1999,
Except for Note 9, as to which the date is February 18, 1999

<ARTICLE> 5

<LEGEND>

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, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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