

**DSP Group Inc.**  
 (NASDAQ-DSPG-\$6.65)

<b>Sector</b>	<b>DSP Applications</b>
<b>Reason for Report</b>	<b>1Q09 Results</b>

Reiterating Hold and raising price target to \$6.00 from \$5.50 reflecting slight improvement in profitability metrics. We believe growth prospects remain limited on the back of contracted economy and lack of new product adoptions. DSPG's EV/Sales of 0.4x remains low, reflecting expectations for negative growth and significantly lower margins.

**Investment Thesis & Valuation.** We remain negative on the cordless phone industry as a whole. We believe the slight improvement in margins this quarter and throughout the remainder of 2009 is a sheer result of cost cutting measures rather than growth. DSPG trades at 2009 EV/Sales of 0.4x, a discount compared to peers.

**1Q09 Mixed Results.** DSPG reported revenues of \$39.9M, in line with management's guidance (\$36M-\$42M) and Non-GAAP loss per share of \$0.18, which exceeded our and the Street forecasts of losses of \$0.26 and \$0.31, respectively. Gross margin was 34.1%, circa 220 basis points better than the Street estimates. The Company generated \$4.5M in operating cash and repurchased 16% of NXP's outstanding shares.

**Guidance In-line.** Management 2Q09 guidance range is \$47M-\$53M, hence we maintain our original revenue forecast of \$49.8M (effectively reflecting the midpoint of that range). We are modeling a higher gross margin for 2Q09 on the back of more upbeat forecasts by management.

Our 2Q09 EPS loss per share remains unchanged at \$0.14, as the increase in R&D expenses mitigate the improved outlook for gross margin. Our 2009 estimates call for revenues of \$205.1M (reflecting 33% negative growth Y/Y) and EPS loss of \$0.30.

**Table 1: Forecasts and Ratios (US\$M)**

FY Dec	2007A	2008A	2009E	2010E
Revenues	248.8	305.8	205.1	220.6
Growth YoY (%)	14.7%	22.9%	-32.9%	7.6%
EBIT	23.2	13.5	-10.7	-8.0
Net Income	29.2	13.8	-7.5	-5.1
EPS (US\$)	0.99	0.50	-0.30	-0.22
P/E (x)	6.1	12.1	-19.9	-27.3
EV/EBIT (x)	2.3	3.9	-4.9	-6.6
ROE (%)	10.8%	5.1%	-2.8%	-1.9%

Source: Company Data and Oscar Gruss Estimates

**HOLD (Unchanged)**
**\$6.00 (Previously: \$5.50)**

Market Cap (US\$M)	173.45
Enterprise Value (US\$M)	69.45
Shares Outstanding (M)	26.08
Share Float	76%
Short Interest Ratio	4.1
3 Mo. Average Daily Volume	121,174
52 Week Range (US\$)	3.83 - 12.98

**Oscar Gruss Estimates (Non-GAAP)**

FY Dec	2Q08A	1Q09A	2Q09E
Revenues (US\$M)	74.2	39.9	49.8
Previous	--	--	--
EPS (US\$)	0.04	(0.18)	(0.14)
Previous	--	--	--

**1Q09 Growth and Margin Analysis**

Rev Growth (YoY)	-45.1%	Gross Margin	34.1%
Rev Growth (QoQ)	-44.2%	Operating Margin	-14.1%
EPS Growth (YoY)	N/A	Net Margin	-11.6%

**Valuation and Performance Ratios**

P/E (FY09E)	N/A	Net Cash/Share	\$3.99
PEG (FY08-10E)	N/A	TL Liab/TL Assets	26.9%
P/Sales (FY09E)	0.8	DSO	54
EV/Sales (FY09E)	0.3	ROE	2.9%
EV/EBIT (FY09E)	-6.5	Operating CF (\$M)	4.5

**Jonathan Kreizman**  
**+972-3-519-9004**  
**jkreizman@oscargruss.co.il**

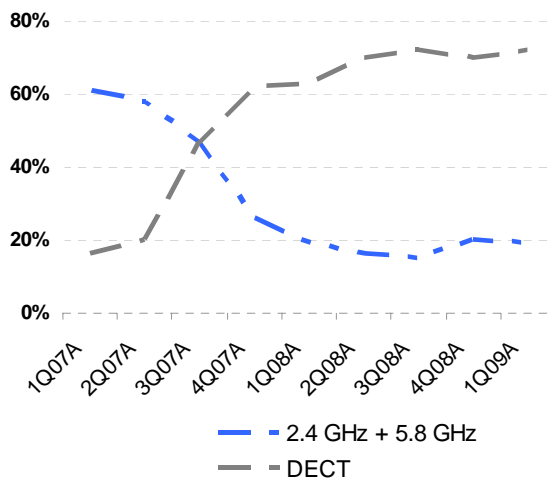
Ziv Tal  
 +972-3-519-9007  
 ztal@oscargruss.co.il

**New York**  
 292 Madison, 14 Floor  
 New York, NY 10017

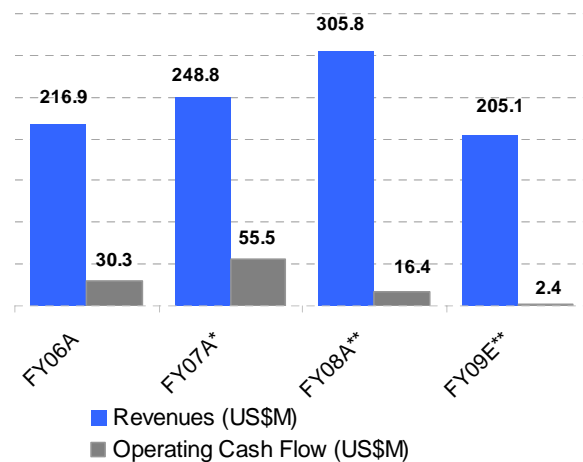
**Tel Aviv**  
 30 Kalisher Street  
 Tel Aviv, Israel 65257

**1Q09 Signaling The Way Up?** While the answer to this question is probably yes we remain skeptical with regards to the Company's ability to significantly improve gross margins as global economy dictates challenging pricing environment. A more important aspect in our view would be to identify new sources for reignited future growth. The new features and products introductions don't strike us as significant contributors to future growth. Product trends seem generally stable with sales from DECT at 72% (2% higher Q/Q), reflecting notable momentum in North America. Sales from 5.8 GHz and 2.4 GHz chipsets totaled \$7.6 million, comprising 19%. Analog, DVR and VoIP stood in for the remaining 9% of sales.

**Product Breakdown (%)**



**Revenues & Operating Cash Flow**



Source: Company Data and Oscar Gruss Estimates

\*NXP acquisition consolidated as of Sept. 10, 2007  
 \*\*NXP acquisition fully consolidated

**Balance Sheet Highlights.** Net cash decreased during the March quarter by \$17.4M, totaling \$104.1M, or \$4.0 per share. DSPG repurchased during 1Q09 4.2M shares for a total cost of \$20.1M, in excess of the normal circa 1M shares of buyback per quarter. The difference stems from the repurchase of DSPG shares, held by NXP in connection with the NXP acquisition by DSPG, a year ago. DSOs were 54, up 4 days compared with the previous quarter. Inventory turnover decreased to 8.6 from 12.3 in 4Q08, within the normal range presented in the last few years.

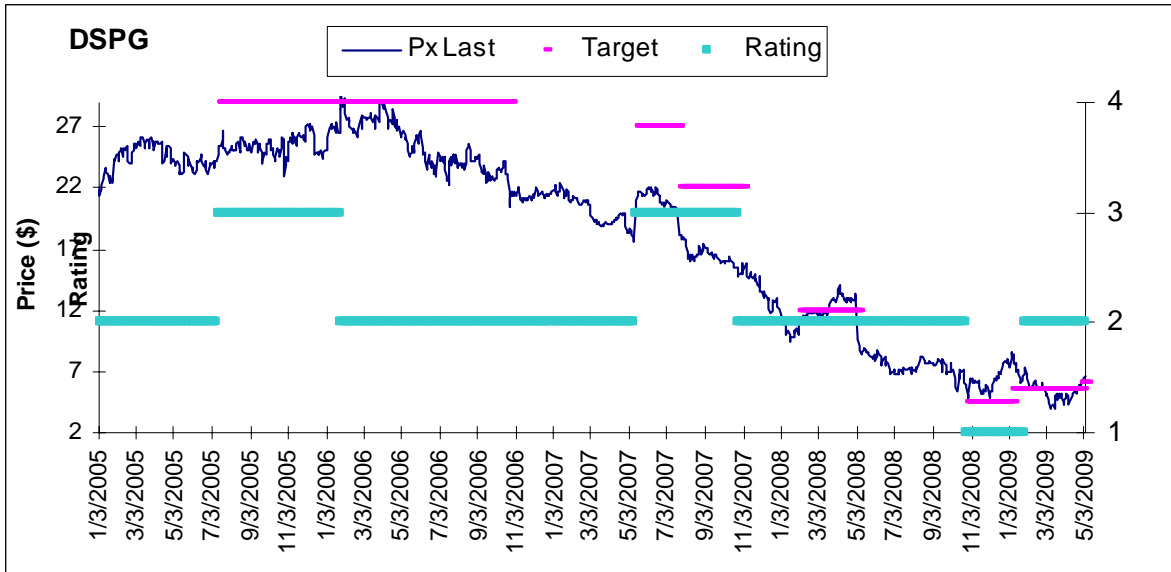
**Risks.** (1) Continued decline in consumer spending (2) Cordless telephony growth compromised by the penetration of new technologies such as FMC and Femtocells (3) Company's residential multimedia and picture frame initiatives dry up (4) Loss of a substantial OEM customer (5) Political and/or terror-related risks connected to DSPG's facilities located in Israel.

### Income Statement Model (Non-GAAP)

(\$ millions, except per share data)	2007A	1Q08A	2Q08A	3Q08A	4Q08A	2008A	1Q09A	2Q09E	3Q09E	4Q09E	2009E	2010E
<b>Product Revenues and other</b>	<b>248.8</b>	<b>72.7</b>	<b>74.2</b>	<b>87.4</b>	<b>71.6</b>	<b>305.8</b>	<b>39.9</b>	<b>49.8</b>	<b>61.3</b>	<b>54.1</b>	<b>205.1</b>	<b>220.6</b>
<b>Cost of product revenues and other</b>	<b>146.8</b>	45.5	47.9	54.3	43.1	<b>190.9</b>	26.3	31.7	39.1	33.6	<b>130.7</b>	<b>142.3</b>
<b>Gross profit (loss)</b>	<b>102.0</b>	<b>27.2</b>	<b>26.2</b>	<b>33.1</b>	<b>28.4</b>	<b>114.9</b>	<b>13.6</b>	<b>18.1</b>	<b>22.2</b>	<b>20.5</b>	<b>74.4</b>	<b>78.3</b>
Research and development	51.3	17.9	17.0	16.3	15.4	66.6	12.2	14.7	14.7	14.2	55.8	56.3
Sales and marketing	18.3	5.5	5.2	5.1	5.2	21.0	4.1	4.3	4.2	4.2	16.8	17.2
General and administrative	9.1	3.1	3.5	3.5	3.6	13.8	3.0	3.1	3.2	3.2	12.5	12.8
<b>Total operating expenses</b>	<b>78.8</b>	26.6	25.7	24.9	24.2	<b>101.4</b>	19.3	22.1	22.1	21.6	<b>85.1</b>	<b>86.3</b>
<b>Operating income (loss)</b>	<b>23.2</b>	<b>0.6</b>	<b>0.5</b>	<b>8.1</b>	<b>4.2</b>	<b>13.5</b>	<b>(5.6)</b>	<b>(4.0)</b>	<b>0.1</b>	<b>(1.1)</b>	<b>(10.7)</b>	<b>(8.0)</b>
Interest and other income, net	11.5	1.2	0.9	0.5	0.5	3.1	0.6	0.5	0.5	0.5	2.1	2.0
Income after financial and other	34.7	1.8	1.4	8.6	4.7	16.6	(5.0)	(3.5)	0.6	(0.6)	(8.6)	(6.0)
Provision (benefit) for (from) income taxes	5.5	0.4	0.4	1.3	0.8	2.8	(0.4)	(0.3)	(0.3)	(0.1)	(1.1)	(0.9)
<b>Non-GAAP net income</b>	<b>29.2</b>	<b>1.4</b>	<b>1.0</b>	<b>7.4</b>	<b>4.0</b>	<b>13.8</b>	<b>(4.6)</b>	<b>(3.2)</b>	<b>0.9</b>	<b>(0.5)</b>	<b>(7.5)</b>	<b>(5.1)</b>
FAS123 expenses	15.0	3.3	2.7	4.7	11.1	21.8	3.0	3.0	3.1	3.1	12.2	12.0
Amortization related exp.	19.0	5.8	5.7	5.7	187.3	204.5	3.0	3.1	3.1	3.1	12.3	12.4
<b>GAAP net income</b>	<b>(4.8)</b>	<b>(7.6)</b>	<b>(7.4)</b>	<b>(3.0)</b>	<b>(194.4)</b>	<b>(212.4)</b>	<b>(10.7)</b>	<b>(9.3)</b>	<b>(5.3)</b>	<b>(6.7)</b>	<b>(32.0)</b>	<b>(29.5)</b>
Wtg Average number of shares (MM fully diluted)	29.6	30.8	28.4	27.7	26.9	28.4	26.1	22.8	22.9	23.1	23.7	23.2
<b>Non GAAP EPS</b>	<b>0.99</b>	<b>0.05</b>	<b>0.04</b>	<b>0.27</b>	<b>0.15</b>	<b>0.50</b>	<b>(0.18)</b>	<b>(0.14)</b>	<b>0.04</b>	<b>(0.02)</b>	<b>(0.30)</b>	<b>(0.22)</b>
<b>GAAP EPS (including option expensing as of 1Q06)</b>	<b>(0.16)</b>	<b>(0.25)</b>	<b>(0.26)</b>	<b>(0.11)</b>	<b>(7.23)</b>	<b>(7.84)</b>	<b>(0.41)</b>	<b>(0.41)</b>	<b>(0.23)</b>	<b>(0.29)</b>	<b>(1.34)</b>	<b>(1.27)</b>
<b>Margin Analysis</b>												
Gross	41.0%	37.4%	35.4%	37.9%	39.7%	37.6%	34.1%	36.3%	36.2%	37.9%	36.3%	35.5%
Net R&D as % of revenues	20.6%	24.7%	22.9%	18.6%	21.5%	21.8%	30.5%	29.5%	24.0%	26.2%	27.2%	25.5%
Sales and marketing % of revenues	7.4%	7.6%	7.0%	5.9%	7.2%	6.9%	10.2%	8.6%	6.9%	7.8%	8.2%	7.8%
SG&A as % of revenues	11.0%	11.9%	11.8%	9.9%	12.2%	11.4%	17.8%	14.9%	12.1%	13.7%	14.3%	13.6%
Operating	9.3%	0.8%	0.7%	9.3%	5.9%	4.4%	(14.1%)	(8.1%)	0.1%	(2.0%)	(5.2%)	(3.6%)
Taxes percentage	15.8%	22.1%	26.9%	14.6%	15.9%	16.8%	8.2%	8.5%	(50.8%)	16.8%	13.0%	15.0%
Net	11.7%	2.0%	1.4%	8.4%	5.6%	4.5%	(11.6%)	(6.5%)	1.5%	(0.9%)	(3.6%)	(2.3%)
Sales growth Q/Q		(14.6%)	2.0%	17.8%	(18.1%)		(44.2%)	24.8%	23.1%	(11.7%)		
Sales growth Y/Y	14.7%	47.6%	41.4%	41.2%	(16.0%)	22.9%	(45.1%)	(32.8%)	(29.8%)	(24.4%)	(32.9%)	7.6%

Source: Company reports and Oscar Gruss estimates

Historical Price Chart



Ratings Scale: 1 - Reduce, 2 - Hold, 3 - Buy

Note: Price chart adjusted for dividends and splits. Past ratings have been recalibrated to reflect the current ratings scale.



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## TECHNOLOGY & TELECOM

## RISK ARBITRAGE & SPECIAL SITUATIONS

Peter Lyons	(212) 514-2409	Louis Meyer	(212) 514-2411
Ziv Tal	+(972) 3519-9007	Mark Gardyn	(212) 514-2410
Jonathan Kreizman	+(972) 3519-9004	Gideon Sharir	(212) 514-2406
		<b>CREDIT ANALYST</b>	
		Jeffrey Laverty	(212) 514-2407

## EQUITY

## RISK ARBITRAGE & SPECIAL SITUATIONS

<b>SALES - TRADING</b>	(212) 514-2300	<b>SALES - TRADING</b>	(212) 514-2300
Tim Brackett		Laura Anreder	
Chris Selicious		Andy Lyss	
Yuval Amiram	+(972) 3519-9019	Chuck Whitman	
<b>SALES - TRADING (EUROPE)</b>	(212) 514-2460	Bob Gillis	
Marcel Tschan		Michael O'Brien	
Ira Fortgang			

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Rating (as of 05/04/09)	# of securities in OG universe with this rating:	% of securities in OG universe with this rating:	# of companies for which Investment Banking ser- vices have been provided:	% of companies for which Investment Banking ser- vices have been provided:
Buy	44	57.89%	0	0%
Hold	20	26.32%	0	0%
Sell / Reduce	12	15.79%	0	0%

More information available on request.

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