

CEVA INC  
Form 10-Q  
August 09, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended: June 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49842

**CEVA, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of Incorporation or Organization)

**77-0556376**  
(I.R.S. Employer Identification No.)

**1943 Landings Drive, Mountain View, California**  
(Address of Principal Executive Offices)

**94043**  
(Zip Code)

**(650) 417-7900**

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 22,063,407 shares of common stock, \$0.001 par value, as of Aug 2, 2013.

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**FORWARD-LOOKING STATEMENTS**

**FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA**

This Quarterly Report contains forward-looking statements that involve risks and uncertainties, as well as assumptions that if they materialize or prove incorrect, could cause the results of CEVA to differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, should, could, expect, suggest, believe, anticipate, intend, plan, or other similar words. Forward-looking statements include the following:

We believe the adoption of our DSP cores and technologies in the handset and mobile broadband markets continues to progress;

Our belief that the emergence of low cost smartphone platforms integrating 3G cellular connectivity from companies such as Broadcom, Intel and Spreadtrum, all of whom are our customers, are strong positive drivers for our future market share expansion;

Our belief that we are well positioned to leverage (1) the increased adoption of low cost 3G smartphones in developing countries, (2) the broad adoption of 4G LTE-based advanced smartphones in mature markets further down the road, (3) the introduction of feature set enhancements in audio, digital photography and embedded vision in smart devices, and (4) the growing adoption of heterogeneous cellular network composed of small cell in conjunction of macro base station;

Our belief that our imaging, vision, audio and voice product lines enable us to continue to expand our licensee base in the market for non-baseband applications;

Our belief that the following key elements represent significant growth drivers for us: (1) our established market presence in the baseband market, (2) our proven track record in baseband technologies, (3) the spectral efficiency of LTE presenting new opportunities for DSP-related products, and (4) the market potential for digital photography and vision analytics in cameras offering a new growth segment for the company;

Our anticipation that our current cash on hand, short-term deposits and marketable securities, along with cash from operations, will provide sufficient capital to fund our operations for at least the next 12 months;

Our belief that changes in interest rates within our investment portfolio will not have a material effect on our financial position on an annual or quarterly basis; and

Market data prepared by third parties, including ABI Research, Gartner and Strategy Analytics. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this report are based on information that is currently available to us and expectations and assumptions that we deem reasonable at the time the statements were made. We do not undertake any obligation to update any forward-looking statements in this report or in any of our other communications, except as required by law. All such forward-looking statements should be read as of the time the statements were made and with the recognition that these forward-looking statements may not be complete or accurate at a later date.

Many factors may cause actual results to differ materially from those expressed or implied by the forward-looking statements contained in this report. These factors include, but are not limited to, those risks set forth in Part II Item 1A Risk Factors of this Form 10-Q.

This report contains market data prepared by third party research firm. Actual market results may differ from their projections.



**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS**

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

|  | <b>June 30,<br/>2013<br/>Unaudited</b> | <b>December 31,<br/>2012<br/>Audited</b> |
|--|--|--|
| <b>ASSETS</b>  |  |  |
| Current assets:  |  |  |
| Cash and cash equivalents  | \$ 7,539                               | \$ 18,422                                |
| Short term bank deposits   | 39,354                                 | 47,229                                   |
| Marketable securities  | 79,273                                 | 69,343                                   |
| Trade receivables  | 9,186                                  | 6,232                                    |
| Deferred tax assets  | 2,565                                  | 2,065                                    |
| Prepaid expenses and other current assets  | 3,071                                  | 2,361                                    |
| <b>Total current assets</b>  | <b>140,988</b>                         | <b>145,652</b>                           |
| Long term bank deposits  | 28,226                                 | 23,050                                   |
| Severance pay fund   | 6,615                                  | 6,130                                    |
| Deferred tax assets  | 1,305                                  | 1,178                                    |
| Property and equipment, net  | 1,707                                  | 1,392                                    |
| Goodwill   | 36,498                                 | 36,498                                   |
| Investments in other companies   | 2,733                                  | 2,433                                    |
| <b>Total long-term assets</b>  | <b>77,084</b>                          | <b>70,681</b>                            |
| <b>Total assets</b>  | <b>\$ 218,072</b>                      | <b>\$ 216,333</b>                        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |  |  |
| Current liabilities:   |  |  |
| Trade payables   | \$ 1,198                               | \$ 1,176                                 |
| Deferred revenues  | 539                                    | 865                                      |
| Accrued expenses and other payables  | 2,595                                  | 3,462                                    |
| Accrued payroll and related benefits   | 6,411                                  | 6,978                                    |
| Income taxes payable, net  | 2,127                                  | 1,626                                    |
| <b>Total current liabilities</b>   | <b>12,870</b>                          | <b>14,107</b>                            |
| Long term liabilities:   |  |  |
| Accrued severance pay  | 6,722                                  | 6,158                                    |
| Stockholders equity:   |  |  |
| Preferred Stock:   |  |  |
| \$0.001 par value: 5,000,000 shares authorized; none issued and outstanding  |  |  |
| Common Stock:  |  |  |
| \$0.001 par value: 60,000,000 shares authorized; 23,595,160 shares issued both at June 30, 2013 and December 31, 2012, and 22,038,307 and 22,187,367 shares outstanding at June 30, 2013 and December 31, 2012, respectively |  |  |
|  | 22                                     | 22                                       |
| Additional paid in-capital   | 201,159                                | 198,495                                  |
| Treasury stock at cost (1,556,853 and 1,407,793 shares of common stock at June 30, 2013 and December 31, 2012, respectively)   | (27,737)                               | (25,694)                                 |

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|   |                |                |
|---|----------------|----------------|
| Accumulated other comprehensive income (loss) | (367)          | 360            |
| Retained earnings                             | 25,403         | 22,885         |
| <b>Total stockholders' equity</b>             | <b>198,480</b> | <b>196,068</b> |
| Total liabilities and stockholders' equity    | \$ 218,072     | \$ 216,333     |

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

**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

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

|   | Six months ended |           | Three months ended |          |
|---|------------------|-----------|--------------------|----------|
|   | June 30,         |           | June 30,           |          |
|   | 2013             | 2012      | 2013               | 2012     |
| <b>Revenues:</b>  |                  |           |                    |          |
| Licensing and related revenue   | \$ 11,163        | \$ 12,003 | \$ 6,129           | \$ 5,997 |
| Royalties   | 13,766           | 16,701    | 6,684              | 7,595    |
| Total revenues  | 24,929           | 28,704    | 12,813             | 13,592   |
| Cost of revenues  | 2,668            | 1,881     | 1,093              | 1,011    |
| Gross profit  | 22,261           | 26,823    | 11,720             | 12,581   |
| <b>Operating expenses:</b>  |                  |           |                    |          |
| Research and development, net   | 10,660           | 10,911    | 5,621              | 5,425    |
| Sales and marketing   | 4,895            | 4,393     | 2,540              | 2,104    |
| General and administrative  | 3,582            | 3,718     | 1,744              | 1,849    |
| Total operating expenses  | 19,137           | 19,022    | 9,905              | 9,378    |
| Operating income  | 3,124            | 7,801     | 1,815              | 3,203    |
| Financial income, net   | 1,436            | 1,922     | 707                | 974      |
| Income before taxes on income   | 4,560            | 9,723     | 2,522              | 4,177    |
| Income taxes  | 680              | 1,387     | 347                | 698      |
| Net income  | \$ 3,880         | \$ 8,336  | \$ 2,175           | \$ 3,479 |
| Basic net income per share  | \$ 0.18          | \$ 0.36   | \$ 0.10            | \$ 0.15  |
| Diluted net income per share  | \$ 0.17          | \$ 0.35   | \$ 0.10            | \$ 0.15  |
| <b>Weighted-average shares used to compute net income per share (in thousands):</b> |                  |           |                    |          |
| Basic   | 22,142           | 23,188    | 22,087             | 22,873   |
| Diluted   | 22,608           | 23,842    | 22,546             | 23,449   |

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



**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

U.S. dollars in thousands

|   | <b>Six months ended<br/>June 30,</b> |             | <b>Three months ended<br/>June 30,</b> |             |
|---|--------------------------------------|-------------|--|-------------|
|   | <b>2013</b>                          | <b>2012</b> | <b>2013</b>                            | <b>2012</b> |
| Net income:   | \$ 3,880                             | \$ 8,336    | \$ 2,175                               | \$ 3,479    |
| Other comprehensive income (loss) before tax:   |                                      |             |  |             |
| Available-for-sale securities:  |                                      |             |  |             |
| Changes in unrealized gains (losses)  | (689)                                | 841         | (674)                                  | (292)       |
| Reclassification adjustments for gains included in net income                           | (239)                                | (127)       | (96)                                   | (82)        |
| Net change  | (928)                                | 714         | (770)                                  | (374)       |
| Cash flow hedges:   |                                      |             |  |             |
| Changes in unrealized gains   | 218                                  | (56)        | 112                                    | (272)       |
| Reclassification adjustments for gains (losses) included in net income                  | (288)                                | 140         | (188)                                  | 83          |
| Net change  | (70)                                 | 84          | (76)                                   | (189)       |
| Other comprehensive income (loss) before tax  | (998)                                | 798         | (846)                                  | (563)       |
| Income tax benefit (expense) related to components of other comprehensive income (loss) | 271                                  | (221)       | 232                                    | 136         |
| Other comprehensive income (loss), net of taxes   | (727)                                | 577         | (614)                                  | (427)       |
| Comprehensive income  | \$ 3,153                             | \$ 8,913    | \$ 1,561                               | \$ 3,052    |

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

**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

U.S. dollars in thousands

|  | Six months ended<br>June 30, |                  |
|--|------------------------------|------------------|
|  | 2013                         | 2012             |
| <b>Cash flows from operating activities:</b>   |                              |                  |
| Net income   | \$ 3,880                     | \$ 8,336         |
| Adjustments required to reconcile net income to net cash provided by operating activities: |                              |                  |
| Depreciation   | 320                          | 259              |
| Equity-based compensation  | 2,664                        | 2,322            |
| Realized gain, net on sale of available-for-sale marketable securities                     | (239)                        | (127)            |
| Amortization of premiums on available-for-sale marketable securities                       | 751                          | 709              |
| Accrued interest on bank deposits  | (685)                        | (910)            |
| Unrealized foreign exchange loss (gain)  | 20                           | (57)             |
| Changes in operating assets and liabilities:   |                              |                  |
| Decrease (increase) in trade receivables   | (2,954)                      | 414              |
| Decrease (increase) in prepaid expenses and other current assets                           | (767)                        | 600              |
| Increase in deferred taxes, net  | (455)                        | (415)            |
| Increase in trade payables   | 32                           | 444              |
| Decrease in deferred revenues  | (326)                        | (42)             |
| Decrease in accrued expenses and other payables  | (791)                        | (274)            |
| Decrease in accrued payroll and related benefits   | (628)                        | (1,575)          |
| Increase in income taxes payable   | 501                          | 997              |
| Excess tax benefit from equity-based compensation  |                              | (752)            |
| Increase (decrease) in accrued severance pay, net  | 78                           | (78)             |
| <b>Net cash provided by operating activities</b>   | <b>1,401</b>                 | <b>9,851</b>     |
| <b>Cash flows from investing activities:</b>   |                              |                  |
| Purchase of property and equipment   | (635)                        | (201)            |
| Investment in bank deposits  | (31,000)                     | (28,604)         |
| Proceeds from bank deposits  | 34,478                       | 29,073           |
| Investment in available-for-sale marketable securities                                     | (46,317)                     | (20,367)         |
| Proceeds from maturity of available-for-sale marketable securities                         | 5,853                        | 9,150            |
| Proceeds from sale of available-for-sale marketable securities                             | 29,094                       | 25,845           |
| Investment in other company  | (300)                        |                  |
| <b>Net cash provided by (used in) investing activities</b>                                 | <b>(8,827)</b>               | <b>14,896</b>    |
| <b>Cash flows from financing activities:</b>   |                              |                  |
| Purchase of Treasury Stock   | (4,851)                      | (20,793)         |
| Proceeds from exercise of stock-based awards   | 1,446                        | 875              |
| Excess tax benefit from equity-based compensation  |                              | 752              |
| <b>Net cash used in financing activities</b>   | <b>(3,405)</b>               | <b>(19,166)</b>  |
| Effect of exchange rate movements on cash  | (52)                         | (28)             |
| <b>Increase (decrease) in cash and cash equivalents</b>                                    | <b>(10,883)</b>              | <b>5,553</b>     |
| Cash and cash equivalents at the beginning of the period                                   | 18,422                       | 14,954           |
| <b>Cash and cash equivalents at the end of the period</b>                                  | <b>\$ 7,539</b>              | <b>\$ 20,507</b> |

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Supplemental information of cash-flows activities:

Cash paid during the period for:

|  |    |     |    |    |
|--|----|-----|----|----|
| Income and withholding taxes, net of refunds | \$ | 671 | \$ | 50 |
|--|----|-----|----|----|

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

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**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: BUSINESS**

The financial information in this quarterly report includes the results of CEVA, Inc. and its subsidiaries (the Company or CEVA).

CEVA licenses a family of programmable DSP cores and application-specific platforms, including communications (wireless, Wi-Fi and Bluetooth), digital photography and vision, audio, voice, Serial ATA (SATA) and Serial Attached SCSI (SAS).

CEVA's technologies are licensed to leading semiconductor and original equipment manufacturer (OEM) companies in the form of intellectual property (IP). These companies design, manufacture, market and sell application-specific integrated circuits (ASICs) and application-specific standard products (ASSPs) based on CEVA's technology to OEM companies for incorporation into a wide variety of end products.

**NOTE 2: BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The interim condensed consolidated financial statements have been prepared according to U.S. Generally Accepted Accounting Principles (U.S. GAAP).

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Starting January 1, 2013, the Company consolidated other revenues within licensing revenues. Prior period numbers were conformed to the Company's current period presentation of one revenue line titled licensing and related revenue.

The significant accounting policies applied in the annual consolidated financial statements of the Company as of December 31, 2012, contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2013, have been applied consistently in these unaudited interim condensed consolidated financial statements.

***Use of Estimates***

The preparation of the interim condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the interim condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

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

**NOTE 3: MARKETABLE SECURITIES**

The following is a summary of available-for-sale marketable securities at June 30, 2013 and December 31, 2012:

|  | As at June 30, 2013 (Unaudited) |                        |                         |                  |
|--|---------------------------------|------------------------|-------------------------|------------------|
|  | Amortized cost                  | Gross unrealized gains | Gross unrealized losses | Fair value       |
| <b>Available-for-sale securities - matures within one year:</b>                    |                                 |                        |                         |                  |
| Foreign government bond  | \$ 563                          | \$ 2                   | \$                      | \$ 565           |
| Corporate bonds  | 4,497                           | 12                     | (5)                     | 4,504            |
|  | 5,060                           | 14                     | (5)                     | 5,069            |
| <b>Available-for-sale securities - matures after one year through three years:</b> |                                 |                        |                         |                  |
| Corporate bonds  | 74,917                          | 57                     | (770)                   | 74,204           |
|  | 74,917                          | 57                     | (770)                   | 74,204           |
| <b>Total</b>   | <b>\$ 79,977</b>                | <b>\$ 71</b>           | <b>\$ (775)</b>         | <b>\$ 79,273</b> |

|  | As at December 31, 2012 (Audited) |                        |                         |                  |
|--|-----------------------------------|------------------------|-------------------------|------------------|
|  | Amortized cost                    | Gross unrealized gains | Gross unrealized losses | Fair value       |
| <b>Available-for-sale securities - matures within one year:</b>                    |                                   |                        |                         |                  |
| Corporate bonds  | \$ 10,964                         | \$ 73                  | \$ (4)                  | \$ 11,033        |
|  | 10,964                            | 73                     | (4)                     | 11,033           |
| <b>Available-for-sale securities - matures after one year through three years:</b> |                                   |                        |                         |                  |
| Certificates of deposits   | 1,960                             |                        | (1)                     | 1,959            |
| Foreign government bond  | 573                               | 2                      |                         | 575              |
| Corporate bonds  | 55,622                            | 391                    | (237)                   | 55,776           |
|  | 58,155                            | 393                    | (238)                   | 58,310           |
| <b>Total</b>   | <b>\$ 69,119</b>                  | <b>\$ 466</b>          | <b>\$ (242)</b>         | <b>\$ 69,343</b> |

The following table presents gross unrealized losses and fair values for those investments that were in an unrealized loss position as of June 30, 2013 and December 31, 2012, and the length of time that those investments have been in a continuous loss position:

|                         | Less than 12 months |                       | 12 months or greater |                       |
|-------------------------|---------------------|-----------------------|----------------------|-----------------------|
|                         | Fair Value          | Gross unrealized loss | Fair Value           | Gross unrealized loss |
| As of June 30, 2013     | \$ 65,749           | \$ (775)              | \$                   | \$                    |
| As of December 31, 2012 | \$ 28,711           | \$ (241)              | \$ 489               | \$ (1)                |

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As of June 30, 2013 and December 31, 2012, management believes the impairments are not other than temporary and therefore the impairment losses were recorded in accumulated other comprehensive income (loss). The Company has no intent to sell these securities and it is more likely than not that the Company will not be required to sell these securities prior to the recovery of the entire amortized cost basis.

For the three months ended June 30, 2013 and 2012, the Company recognized gross realized gains of \$104 and \$111, respectively, and gross realized losses of \$8 and \$29, respectively. For the six months ended June 30, 2013 and 2012, the Company recognized gross realized gains of \$256 and \$163, respectively, and gross realized losses of \$17 and \$36, respectively.

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

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

**NOTE 4: FAIR VALUE MEASUREMENT**

The Company measures its marketable securities and foreign currency derivative contracts at fair value. Fair value is an exit price, representing the amount that would be received for selling an asset or paid for the transfer of a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

- Level I      Unadjusted quoted prices in active markets that are accessible on the measurement date for identical, unrestricted assets or liabilities;
- Level II     Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level III    Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

The Company measures its marketable securities and foreign currency derivative contracts at fair value. Marketable securities and foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The table below sets forth the Company's assets and liabilities measured at fair value by level within the fair value hierarchy. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| Description                | June 30,<br>2013 | Level I | Level II      | Level III |
|----------------------------|------------------|---------|---------------|-----------|
| <b><u>Assets:</u></b>      |                  |         |               |           |
| Marketable securities:     |                  |         |               |           |
| Foreign government bond    | \$ 565           | \$      | \$ 565        | \$        |
| Corporate bonds            | 78,708           |         | 78,708        |           |
| Foreign exchange contracts | 165              |         | 165           |           |
| <b>Total assets</b>        | <b>79,438</b>    |         | <b>79,438</b> |           |
| <b><u>Liabilities:</u></b> |                  |         |               |           |
| Foreign exchange contracts | 19               |         | 19            |           |
| <b>Total liabilities</b>   | <b>19</b>        |         | <b>19</b>     |           |

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| Description                | December 31,<br>2012 | Level I | Level II      | Level III |
|----------------------------|----------------------|---------|---------------|-----------|
| <b>Assets:</b>             |                      |         |               |           |
| Marketable securities:     |                      |         |               |           |
| Certificates of deposits   | \$ 1,959             | \$      | \$ 1,959      | \$        |
| Foreign government bond    | 575                  |         | 575           |           |
| Corporate bonds            | 66,809               |         | 66,809        |           |
| Foreign exchange contracts | 216                  |         | 216           |           |
| <b>Total assets</b>        | <b>69,559</b>        |         | <b>69,559</b> |           |
| <b>Liabilities:</b>        |                      |         |               |           |
| Foreign exchange contracts | 112                  |         | 112           |           |
| <b>Total liabilities</b>   | <b>112</b>           |         | <b>112</b>    |           |

In addition to the assets and liabilities described above, the Company's financial instruments also include cash, cash equivalents, short term bank deposits, trade receivables, other accounts receivable, trade payables, income taxes payable and other accounts payables. The fair values of these financial instruments were not materially different from their carrying values at June 30, 2013 due to the short-term maturities of these instruments.



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

**NOTE 5: GEOGRAPHIC INFORMATION AND MAJOR CUSTOMER DATA**

## a. Summary information about geographic areas:

The Company manages its business on the basis of one reportable segment: the licensing of intellectual property to semiconductor companies and electronic equipment manufacturers (see Note 1 for a brief description of the Company's business). The following is a summary of revenues within geographic areas:

|                                      | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|--------------------------------------|------------------------------|---------------------|--------------------------------|---------------------|
|                                      | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Revenues based on customer location: |                              |                     |                                |                     |
| United States                        | \$ 3,224                     | \$ 6,177            | \$ 1,571                       | \$ 3,179            |
| Europe and Middle East (1)           | 7,425                        | 7,090               | 3,401                          | 3,412               |
| Asia Pacific (2) (3) (4)             | 14,280                       | 15,437              | 7,841                          | 7,001               |
|                                      | \$ 24,929                    | \$ 28,704           | \$ 12,813                      | \$ 13,592           |
| (1) Germany                          | \$ 3,521                     | \$ 3,399            | \$ 1,837                       | \$ 1,606            |
| (2) China                            | \$ 10,829                    | \$ 9,294            | \$ 6,811                       | \$ 4,056            |
| (3) Japan                            | \$ *)                        | \$ 3,140            | \$ *)                          | \$ *)               |
| (4) S. Korea                         | \$ *)                        | \$ *)               | \$ *)                          | \$ 1,619            |

\*) Less than 10%

## b. Major customer data as a percentage of total revenues:

The following table sets forth the customers that represented 10% or more of the Company's total revenues in each of the periods set forth below.

|            | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|------------|------------------------------|---------------------|--------------------------------|---------------------|
|            | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Customer A | 32%                          | 28%                 | 47%                            | 25%                 |
| Customer B | 14%                          | 12%                 | 14%                            | 12%                 |
| Customer C | *)                           | 12%                 | *)                             | 15%                 |
| Customer D | *)                           | *)                  | *)                             | 12%                 |

\*) Less than 10%



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

**NOTE 6: NET INCOME PER SHARE OF COMMON STOCK**

Basic net income per share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted net income per share is computed based on the weighted average number of shares of common stock outstanding during each period, plus dilutive potential shares of common stock considered outstanding during the period, in accordance with FASB ASC No. 260, Earnings Per Share.

|   | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|---|------------------------------|---------------------|--------------------------------|---------------------|
|   | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| <b>Numerator:</b>                                 |                              |                     |                                |                     |
| Net income  | \$ 3,880                     | \$ 8,336            | \$ 2,175                       | \$ 3,479            |
| <b>Denominator (in thousands):</b>                |                              |                     |                                |                     |
| Weighted-average common stock outstanding         | 22,142                       | 23,188              | 22,087                         | 22,873              |
| Effect of stock options                           | 466                          | 654                 | 459                            | 576                 |
| Diluted weighted average common stock outstanding | 22,608                       | 23,842              | 22,546                         | 23,449              |
| Basic net income per share                        | \$ 0.18                      | \$ 0.36             | \$ 0.10                        | \$ 0.15             |
| Diluted net income per share                      | \$ 0.17                      | \$ 0.35             | \$ 0.10                        | \$ 0.15             |

The weighted average number of shares related to outstanding options excluded from the calculation of diluted net income per share, since their effect was anti-dilutive, was 1,579,315 and 1,521,826 shares for the three and six months ended June 30, 2013, respectively, and 764,861 and 1,212,482 shares for the corresponding periods of 2012.

**NOTE 7: COMMON STOCK AND STOCK-BASED COMPENSATION PLANS**

The Company grants stock options and stock appreciation rights ( SARs ) capped with a ceiling to employees and stock options to non-employee directors of the Company and its subsidiaries and provides the right to purchase common stock pursuant to the Company's 2002 employee stock purchase plan to employees of the Company and its subsidiaries. The SAR unit confers the holder the right to stock appreciation over a preset price of the Company's common stock during a specified period of time. When the unit is exercised, the appreciation amount is paid through the issuance of shares of the Company's common stock. The ceiling limits the maximum income for each SAR unit. SARs are considered an equity instrument as it is a net share settled award capped with a ceiling (400% for SAR grants made during both the three and six months ended June 30, 2013). The options and SARs granted under the company's stock incentive plans have been granted at the fair market value of the Company's common stock on the grant date. Options and SARs granted to employees under stock incentive plans vest at a rate of 25% of the shares underlying the option after one year and the remaining shares vest in equal portions over the following 36 months, such that all shares are vested after four years. Options granted to non-employee directors vest 25% of the shares underlying the option on each anniversary of the option grant. A summary of the Company's stock option and SARs activities and related information for the three months ended June 30, 2013, are as follows:

| Number of<br>options and<br>SAR units | Weighted<br>average<br>exercise | Weighted<br>average<br>remaining | Aggregate<br>intrinsic- |
|---------------------------------------|---------------------------------|----------------------------------|-------------------------|
|---------------------------------------|---------------------------------|----------------------------------|-------------------------|

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|  |           | price    | contractual<br>term | value        |
|--|-----------|----------|---------------------|--------------|
| Outstanding as of March 31, 2013       | 2,525,100 | \$ 15.93 |                     |              |
| granted (1)                            | 787,250   | 16.73    |                     |              |
| Options exercised                      | (82,023)  | 7.56     |                     |              |
| Options/SAR units forfeited or expired | (34,614)  | 21.44    |                     |              |
| Outstanding as of June 30, 2013 (2)    | 3,195,713 | \$ 16.28 | 5.2                 | \$ 9,840,405 |
| Exercisable as of June 30, 2013        | 1,389,462 | \$ 14.12 | 3.3                 | \$ 7,275,632 |

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

- (1) Included 655,250 SAR units which are convertible for a maximum number of shares of the Company's common stock equal to 75% of the SAR units subject to the grant.
- (2) Due to the ceiling imposed on the SAR grants, the outstanding amount equals a maximum of 2,893,526 shares of the Company's common stock issuable upon exercise.

The following table shows the total equity-based compensation expense included in the interim condensed consolidated statements of income:

|  | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|--|------------------------------|---------------------|--------------------------------|---------------------|
|  | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Cost of revenue                                | \$ 150                       | \$ 104              | \$ 81                          | \$ 53               |
| Research and development, net                  | 855                          | 859                 | 409                            | 394                 |
| Sales and marketing                            | 628                          | 439                 | 332                            | 200                 |
| General and administrative                     | 1,031                        | 920                 | 524                            | 430                 |
| <b>Total equity-based compensation expense</b> | <b>\$ 2,664</b>              | <b>\$ 2,322</b>     | <b>\$ 1,346</b>                | <b>\$ 1,077</b>     |

The fair value for the Company's stock options and SARs (other than share issuances in connection with the employee stock purchase plan, as detailed below) granted to employees and non-employees directors was estimated using the following assumptions:

|   | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|---|------------------------------|---------------------|--------------------------------|---------------------|
|   | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Expected dividend yield                   | 0%                           | 0%                  | 0%                             | 0%                  |
| Expected volatility                       | 38%-54%                      | 47%-58%             | 38%-53%                        | 47%-58%             |
| Risk-free interest rate                   | 0.1%-2.5%                    | 0.1%-1.2%           | 0.1%-2.5%                      | 0.2%-1.2%           |
| Expected forfeiture (employees)           | 10%                          | 10%                 | 10%                            | 10%                 |
| Expected forfeiture (executives)          | 5%                           | 5%                  | 5%                             | 5%                  |
| Contractual term of up to                 | 10 Years                     | 10 Years            | 10 Years                       | 10 Years            |
| Suboptimal exercise multiple (employees)  | 2.1                          | 2.1                 | 2.1                            | 2.1                 |
| Suboptimal exercise multiple (executives) | 2.4                          | 2.4                 | 2.4                            | 2.4                 |

The fair value for rights to purchase shares of common stock under the Company's employee share purchase plan was estimated on the date of grant using the same assumptions set forth above relating to the Company's stock options and SARs for the six months ended June 30, 2013 and 2012, except for the expected life, which was assumed to be six to 24 months, and except for the expected volatility, which was assumed to be in a range of 45%-53% for the six months ended June 30, 2013 and in a range of 41%-61% for the six months ended June 30, 2012. The Company did not grant new purchase rights under the 2002 employee stock purchase plan during the three months ended June 30, 2013 and 2012.

As of June 30, 2013, there was \$8,471 of unrecognized compensation expense related to unvested equity awards. This amount is expected to be recognized over a weighted-average period of 1.4 years. To the extent the actual forfeiture rate is different from what the Company has estimated, equity-based compensation related to these awards will be different from the Company's expectations.

**NOTE 8: DERIVATIVES AND HEDGING ACTIVITIES**

The Company follows the requirements of FASB ASC No. 815, Derivatives and Hedging which requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in fair value

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(i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging transaction and further, on the type of hedging transaction. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. Due to the Company's global operations, it is exposed to foreign currency exchange rate fluctuations in the normal course of its business. The Company's treasury policy allows it to offset the risks associated with the effects of certain foreign currency exposures through the purchase of foreign exchange forward or option contracts ( Hedging Contracts ). The policy, however, prohibits the Company from speculating on such

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****(U.S. dollars in thousands, except share data)**

Hedging Contracts for profit. To protect against the increase in value of forecasted foreign currency cash flow resulting from salaries paid in currencies other than the U.S. dollar during the year, the Company instituted a foreign currency cash flow hedging program. The Company hedges portions of the anticipated payroll of its non-U.S. employees denominated in the currencies other than the U.S. dollar for a period of one to twelve months with Hedging Contracts. Accordingly, when the dollar strengthens against the foreign currencies, the decline in present value of future foreign currency expenses is offset by losses in the fair value of the Hedging Contracts. Conversely, when the dollar weakens, the increase in the present value of future foreign currency expenses is offset by gains in the fair value of the Hedging Contracts. These Hedging Contracts are designated as cash flow hedges.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gain or loss on a derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item is recognized in current earnings during the period of change. As of June 30, 2013 and December 31, 2012, the notional principal amount of the Hedging Contracts to sell U.S. dollars held by the Company was \$4,500 and \$5,400, respectively.

Other derivative instruments that are not qualified as hedging instruments consist of forward contracts that the Company uses to hedge monetary assets denominated in currencies other than the U.S. dollar. Gains and losses on these contracts as well as related costs are included in financial income, net, along with the gains and losses of the related hedged item. As of June 30, 2013 and December 31, 2012, the notional principal amount of the foreign exchange contracts to sell New Israeli Shekels ( NIS ) held by the Company was \$0 and \$2,610, respectively.

The fair value of the Company's outstanding derivative instruments is as follows:

|  | As at<br>June 30,<br>2013<br>(Unaudited) | As at<br>December 31,<br>2012<br>(Audited) |
|--|--|--|
| <b>Derivative assets:</b>                                |  |  |
| Derivatives designated as cash flow hedging instruments: |  |  |
| Foreign exchange option contracts                        | \$ 93                                    | \$ 158                                     |
| Foreign exchange forward contracts                       | 72                                       | 58   |
| <b>Total</b>   | <b>\$ 165</b>                            | <b>\$ 216</b>                              |
| <b>Derivative liabilities:</b>                           |  |  |
| Derivatives designated as cash flow hedging instruments: |  |  |
| Foreign exchange forward contracts                       | \$ 19                                    | \$   |
| Derivatives not qualified as hedging instruments:        |  |  |
| Foreign exchange forward contracts                       | \$                                       | \$ 112                                     |
| <b>Total</b>   | <b>\$ 19</b>                             | <b>\$ 112</b>                              |

The Company recorded the fair value of derivative assets in prepaid expenses and other accounts receivable and the fair value of derivative liabilities in accrued expenses and other payables on the Company's interim condensed consolidated balance sheets.

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

The increase in gains (losses) recognized in accumulated other comprehensive income (loss) on derivatives, before tax effect, is as follows:

|  | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|--|------------------------------|---------------------|--------------------------------|---------------------|
|  | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Derivatives designated as cash flow hedging instruments: |                              |                     |                                |                     |
| Foreign exchange option contracts                        | \$ 93                        | \$ (38)             | \$ 25                          | \$ (203)            |
| Foreign exchange forward contracts                       | 125                          | (18)                | 87                             | (69)                |
|  | \$ 218                       | \$ (56)             | \$ 112                         | \$ (272)            |

The gains (losses) reclassified from accumulated other comprehensive income (loss) into income, are as follows:

|  | Six months ended<br>June 30, |                     | Three months ended<br>June 30, |                     |
|--|------------------------------|---------------------|--------------------------------|---------------------|
|  | 2013<br>(unaudited)          | 2012<br>(unaudited) | 2013<br>(unaudited)            | 2012<br>(unaudited) |
| Derivatives designated as cash flow hedging instruments: |                              |                     |                                |                     |
| Foreign exchange option contracts                        | \$ (158)                     | \$ 81               | \$ (98)                        | \$ 49               |
| Foreign exchange forward contracts                       | (130)                        | 59                  | (90)                           | 34                  |
|  | \$ (288)                     | \$ 140              | \$ (188)                       | \$ 83               |

The Company recorded in cost of revenues and operating expenses a net gain of \$188 and \$288 during the three and six months ended June 30, 2013, respectively, and a net loss of \$83 and \$140 for the comparable periods of 2012, related to its Hedging Contracts. In addition, the Company recorded in financial income, net, a gain of \$178 and \$112 during the three and six months ended June 30, 2013, and a gain of \$22 for both the three and six months ended June 30, 2012, related to derivatives not qualified as hedging instruments.

**NOTE 9: ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following table summarizes the changes in accumulated balances of other comprehensive income for the three and six months ended June 30, 2013:

**Three months ended June 30, 2013**

|                   | Unrealized<br>gains (losses)<br>on<br>available-for-sale<br>marketable<br>securities | Unrealized<br>gains (losses)<br>on cash<br>flow<br>hedges | Estimated<br>tax (expense)<br>benefit | Total  |
|-------------------|--|---|---------------------------------------|--------|
| Beginning balance | \$ 66  | \$ 222  | \$ (41)                               | \$ 247 |



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|  |          |        |        |          |
|--|----------|--------|--------|----------|
| Other comprehensive income before reclassifications              | (674)    | 112    | 186    | (376)    |
| Amounts reclassified from accumulated other comprehensive income | (96)     | (188)  | 46     | (238)    |
| Net current period other comprehensive income                    | (770)    | (76)   | 232    | (614)    |
| Ending balance   | \$ (704) | \$ 146 | \$ 191 | \$ (367) |

**Table of Contents****NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

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

**Six months ended June 30, 2013**

|  | Unrealized<br>gains (losses)<br>on<br>available-for-sale<br>marketable<br>securities | Unrealized<br>gains<br>(losses)<br>on<br>cash flow<br>hedges | Estimated<br>tax<br>(expense)<br>benefit | Total    |
|--|--|--|--|----------|
| Beginning balance  | \$ 224   | \$ 216   | \$ (80)                                  | \$ 360   |
| Other comprehensive income before reclassifications              | (689)  | 218  | 174                                      | (297)    |
| Amounts reclassified from accumulated other comprehensive income | (239)  | (288)  | 97                                       | (430)    |
| Net current period other comprehensive income                    | (928)  | (70)   | 271                                      | (727)    |
| Ending balance   | \$ (704)   | \$ 146   | \$ 191                                   | \$ (367) |

The following table provides details about reclassifications out of accumulated other comprehensive income:

| Details about Accumulated Other<br>Comprehensive Income Components | Amount Reclassified from Accumulated Other<br>Comprehensive Income |   | Affected Line Item in the<br>Statement of Income |
|--|--|---|--|
|  | Six months<br>ended<br>June 30,<br>2013<br>(unaudited)             | Three<br>months<br>ended<br>June 30,<br>2013<br>(unaudited) |  |
| Unrealized gains on cash flow hedges                               | \$ 9   | \$ 5  | Cost of revenues                                 |
|  | 236  | 156   | Research and development                         |
|  | 19   | 11  | Sales and marketing                              |
|  | 24   | 16  | General and administrative                       |
|  | 288  | 188   | Total, before income taxes                       |
|  | (29)   | (19)  | Provision for income taxes                       |
|  | 259  | 169   | Total, net of income taxes                       |
| Unrealized gains on available-for-sale<br>marketable securities    | 239  | 96  | Financial income, net                            |
|  | (68)   | (27)  | Provision for income taxes                       |
|  | 171  | 69  | Total, net of income taxes                       |
|  | \$ 430   | \$ 238  | Total, net of income taxes                       |

**NOTE 10: SHARE REPURCHASE PROGRAM**

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In January 2012, the Company's Board of Directors reaffirmed its authorization for the repurchase by the Company of 1,966,700 shares of common stock pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, as amended.

During the second quarter of 2013, the Company repurchased 175,778 shares of common stock at an average purchase price of \$16.21 per share for an aggregate purchase price of \$2,849. During the second quarter of 2012, the Company repurchased 666,679 shares of common stock at an average purchase price of \$16.89 per share for an aggregate purchase price of \$11,258. During the first six months ended June 30 2013, the Company repurchased 304,738 shares of common stock at an average purchase price of \$15.92 per share for an aggregate purchase price of \$4,851. During the first six months ended June 30 2012, the Company repurchased 1,066,742 shares of common stock at an average purchase price of \$19.49 per share for an aggregate purchase price of \$20,793. As of June 30, 2013, 179,414 shares of common stock remained available for repurchase under the Company's share repurchase program.

In July 2013, the Company's Board of Directors authorized the repurchase by the Company of additional 2,000,000 shares of common stock all pursuant to Rule 10b-18 of the Exchange Act.

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**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

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

The repurchases of common stock are accounted for as treasury stock, and result in a reduction of stockholders' equity. When treasury shares are reissued, the Company accounts for the reissuance in accordance with FASB ASC No. 505-30, "Treasury Stock" and charges the excess of the repurchase cost over issuance price using the weighted average method to retained earnings. The purchase cost is calculated based on the specific identified method. In the case where the repurchase cost over issuance price using the weighted average method is lower than the issuance price, the Company credits the difference to additional paid-in capital.

**NOTE 11: RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income which is effective prospectively for public companies for reporting periods beginning after December 15, 2012. This new accounting standard improves the reporting of reclassifications out of accumulated other comprehensive income ( AOCI ) by requiring an entity to report the effect of significant reclassifications out of AOCI. The Company adopted this new guidance on January 1, 2013, and the adoption did not have a material effect on the Company's financial position or results of operations.

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

*You should read the following discussion together with the unaudited financial statements and related notes appearing elsewhere in this quarterly report. This discussion contains forward-looking statements that involve risks and uncertainties. Any or all of our forward-looking statements in this quarterly report may turn out to be wrong. These forward-looking statements can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Factors which could cause actual results to differ materially include those set forth under in Part II Item 1A Risk Factors, as well as those discussed elsewhere in this quarterly report. See Forward-Looking Statements.*

**BUSINESS OVERVIEW**

The financial information presented in this quarterly report includes the results of CEVA, Inc. and its subsidiaries. CEVA is the world's leading licensor of DSP cores and platform solutions. Our technologies are widely licensed and power many of the world's leading semiconductor and original equipment manufacturer (OEM) companies. In 2012, our licensees shipped more than one billion CEVA-powered chipsets targeted for a wide range of diverse end markets. To date, more than 4.5 billion CEVA-powered devices have shipped, illustrating the strong market deployment of our technology.

During the past six years but to lesser extent in 2012, our business has shown profitability and market share expansion as a result of the widespread deployment of our DSP cores with all major handset OEMs, including Blackberry, HTC, Huawei, Lenovo, LG Electronics, Motorola, Nokia, Samsung, Sony and ZTE. Based on internal data and Strategy Analytics' worldwide shipment data, CEVA's worldwide market share of cellular baseband chips that incorporate our technologies was approximately 44% of the worldwide shipment volume based on preliminary data for first quarter 2013 worldwide shipments. Revenues derived from the handset and mobile broadband markets accounted for approximately 83% of our total revenues for the first half of 2013.

We believe the adoption of our DSP cores and technologies in the handset and mobile broadband markets continues to progress. Specifically, we believe the emergence of low cost smartphone platforms integrating 3G cellular connectivity from companies such as Broadcom, Intel and Spreadtrum, all of whom are our customers, are strong positive drivers for our future market share expansion. Moreover, Strategy Analytics forecasts that worldwide cellular baseband shipments will grow by 6.3% in 2013 to reach 2.4 billion units. We believe that the majority of this growth will come from the increased adoption of low cost 3G smartphones in developing countries, especially China, the broader adoption of 4G LTE-based advanced smartphones in mature markets further down the road, as well as the introduction of feature set enhancements in audio, digital photography and embedded vision in smart devices. In addition, we are well positioned to capitalize on the success in handsets to expand into heterogeneous cellular networks composed of small cell and macro base stations.

Beyond products enabled by our technologies for cellular baseband communications, we continue to strategically target growth in non-baseband applications, such as audio, voice, digital photography, embedded vision and connectivity. As a testament to this, during the second quarter we signed two key OEMs in the mobile space for our CEVA-MM3101 imaging and vision platform and a leading audio supplier in China for our CEVA-TeakLite-4 DSP.

We believe the following key elements represent significant growth drivers for the Company:

CEVA is firmly established in the largest space in the semiconductor industry – baseband for mobile handset – as well as the other evolving cellular markets, such as mobile computing and machine to machine. Our competitive edge in software-defined radio technology for the next generations of LTE, Wi-Fi access point and broadband satellite communications, and the inherent low cost and power performance balance of our technologies, puts us in a strong position to simultaneously capitalize on mass market adoption and address all of the growth vectors of the space.

Our proven track record in baseband technologies, in particular our pioneering position in software-defined radio, allows us to expand into the base station market, including the high volume potential in small cells.

The spectral efficiency of LTE enables additional and very interesting new opportunities for DSP-related products. One such use is Voice Over LTE, where higher bit rate speech codecs combined with advanced noise and echo cancellation, allow substantially

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clearer phone calls along with higher intelligibility that is required for services such as voice recognition.

The market potential for digital photography and vision analytics in cameras offers a new growth segment for the company. Our CEVA-MM3101 platform is the only one in the industry today that offers a unified digital photography and vision platform that can support these future developments. Per ABI Research, one billion cameras were shipped in 2012, and this number is predicted to grow to 2.7 billion in 2017. 80% of this volume is attributable to smartphones, where we already have a strong foothold through our other technologies. Mobile OEMs are looking for new DSLR features such as smarter autofocus, best picture using super resolution algorithms, and better image capture in low-light

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environments. Furthermore, with the addition of video analytics support, cameras will enable new services like augmented reality, gesture recognition and advanced safety capabilities in cars. We see this new revolution as an emerging opportunity for us to significantly expand our footprint in smartphones and further into tablets, PCs and automotive applications.

Notwithstanding the various growth opportunities we have outlined above, our business operates in a highly competitive environment. The maintenance of our competitive position and our future growth are dependent on our ability to adapt to ever-changing technologies, short product life cycles, evolving industry standards, changing customer needs and the trend towards cellular connectivity, and voice, audio and video convergence in the markets that we operate. Competition has historically increased pricing pressures for our products and decreased our average selling prices. Royalty payments under our existing license agreements also could be lower than currently anticipated for a variety of reasons, including decreased royalty rates triggered by larger volume shipments, lower royalty rates negotiated with customers due to competitive pressure or consolidation among our customers. Moreover, some of our competitors have reduced their licensing and royalty fees to attract customers and expand their market share. In order to penetrate new markets and maintain our market share with our existing products, we may need to offer our products in the future at lower prices which may result in lower profits. In addition, our future growth is dependent not only on the continued success of our existing products but also the successful introduction of new products, which requires the dedication of resources into research and development which in turn may increase our operating expenses. Furthermore, since our products are incorporated into end products of our OEM and semiconductor customers, our business is very dependent on their ability to achieve market acceptance of their end products in the handset and consumer electronic markets, which are similarly very competitive. In addition, macroeconomic trends may significantly affect our operating results. For example, consolidation among our customers may negatively affect our revenue source, increase our existing customers' negotiation leverage and make us more dependent on a limited number of customers. Also, since we derive a significant portion of our revenues from the handset market, any negative trends in that market would adversely affect our financial results.

However, the semiconductor and consumer electronics industries remain volatile, which makes it extremely difficult for our customers and us to accurately forecast financial results and plan for future business activities. Our license arrangements have not historically provided for substantial ongoing license payments so revenue recognized from licensing arrangements vary significantly from period to period, depending on the number and size of deals closed during a quarter, and is difficult to predict. Moreover, our royalty revenue is based on the sales of products incorporating the semiconductors or other products of our customers, and as a result we do not have direct access to information that will help us anticipate the timing and amount of future royalties. We have very little visibility into the timetable of product shipments incorporating our technology by our customers. As a result, our past operating results should not be relied upon as an indication of future performance.

## **RESULTS OF OPERATIONS**

### *Total Revenues*

Total revenues were \$12.8 million and \$24.9 million for the second quarter and first half of 2013, respectively, representing a decrease of 6% and 13%, respectively, as compared to the corresponding periods in 2012. The decrease in total revenues for the second quarter of 2013 mainly reflected lower royalty revenues. The decrease in total revenues for the first half of 2013 reflected lower licensing and related revenues and lower royalty revenues.

Five largest customers accounted for 82% and 68% of our total revenues for the second quarter and first half of 2013, respectively, as compared to 73% and 67% for the comparable periods in 2012. Two customers accounted for 47% and 14% of our total revenues for the second quarter of 2013, as compared to four customers that accounted for 25%, 12%, 15% and 12% of our total revenues for the second quarter of 2012. Two customers accounted for 32% and 14% of our total revenues for the first half of 2013, as compared to three customers that accounted for 28%, 12% and 12% of our total revenues for the first half of 2012. Generally, the identity of our customers representing 10% or more of our total revenues varies from period to period, especially with respect to our licensing customers as we generate licensing revenues generally from new customers on a quarterly basis. With respect to our royalty revenues, four royalty paying customers each represented 10% or more of our total royalty revenues for the second quarter and first half of 2013 and 2012, and collectively represented 86% and 82% of our total royalty revenues for the second quarter and first half of 2013, respectively, and 76% and 75% of our total royalty revenues for the comparable periods of 2012. We expect that a significant portion of our future royalty revenue will continue to be generated by a limited number of customers. The concentration of our customers is explainable in part by consolidation in the semiconductor industry. The loss of any significant customer could adversely affect our near-term future operating results.

Our total revenues derived from the handsets and mobile broadband markets represented 85% and 83% of our total revenues for the second quarter and first half of 2013, respectively, as compared to 80% and 79% for the comparable periods in 2012.

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### Licensing and Related Revenues

Licensing and related revenues were \$6.1 million and \$11.2 million for the second quarter and first half of 2013, respectively, an increase of 2% and a decrease of 7% from the second quarter and first half of 2012, respectively. The increase in licensing and related revenues for the second quarter of 2013 principally reflected higher revenues from our CEVA-X DSP core family of products, partially offset by lower revenues from our CEVA-TeakLite core family of products and our Bluetooth IP. The decrease in licensing and related revenues for the first half of 2013 principally reflected lower revenues from our CEVA-TeakLite core family of products and our Bluetooth IP, partially offset by higher revenues from our CEVA-X DSP core family of products.

Licensing and related revenues accounted for 48% and 45% of our total revenues for the second quarter and first half of 2013, respectively, compared to 44% and 42% for the comparable periods of 2012. During the second quarter of 2013, we concluded six new license agreements. Four agreements were for CEVA DSP cores, platforms and software, including two comprehensive agreements for our CEVA-MM3101 multimedia platforms with key OEMs in the mobile space who are expected to utilize our technology to develop their own proprietary multimedia processing chips. These two agreements demonstrate our success in capitalizing on the emerging technology trends in photography, vision and audio, and building the foundations for potential future royalty growth. In addition, one agreement was for CEVA SATA/SAS IP and one agreement was for CEVA Bluetooth IP. Target applications for customer deployment are 3G and LTE cellular handsets, imaging, and embedded vision and audio for mobile devices. Geographically, one of the agreements concluded was in the U.S., and the other five were in Asia Pacific, including Japan.

Licensing and related revenues include IP licensing fees, support and training for licensees and sales of development systems. As post contract support, training and sale of development systems are directly associated with licensing revenue and none of them separately is significant in relation to our total revenue, starting in the first quarter of 2013, we consolidated licensing revenue and other revenue into one revenue line titled licensing and related revenue for the sake of simplicity.

### Royalty Revenues

Royalty revenues were \$6.7 million and \$13.8 million for the second quarter and first half of 2013, respectively, a decrease of 12% and 18% from the second quarter and first half of 2012. Royalty revenues accounted for 52% and 55% of our total revenues for the second quarter and first half of 2013, respectively, compared to 56% and 58% for the comparable periods of 2012. The decrease in royalty revenues for the second quarter and first half of 2013 reflected mainly: (1) a decrease in the average per unit royalty rate, especially in the non-baseband markets, due to a product mix change; (2) price erosion which had a direct negative effect on our royalty revenues as some of our royalty arrangements are based on a percentage of chip sales price; and (3) lower volume of consumer electronic products shipped incorporating our technology, partially offset by higher volumes of 3G products shipped incorporating our technology which also bear higher royalty average selling prices than 2G products. Our customers reported sales of 281 million chipsets and 564 million chipset incorporating our technologies for the second quarter and first half of 2013, respectively, compared to 247 million and 525 million for the comparable periods of 2012. The five largest royalty-paying customers accounted for 90% and 87% of our total royalty revenues for the second quarter and first half of 2013, respectively, compared to 82% and 83% for the comparable periods of 2012.

As of June 30, 2013, 29 licensees were shipping products incorporating our technologies pursuant to 35 licensing arrangements. As of June 30, 2012, 28 licensees were shipping products incorporating our technologies pursuant to 36 licensing arrangements.

### Geographic Revenue Analysis

|                            | First Half<br>2013                |     | First Half<br>2012 |     | Second Quarter<br>2013 |     | Second Quarter<br>2012 |     |
|----------------------------|-----------------------------------|-----|--------------------|-----|------------------------|-----|------------------------|-----|
|                            | (in millions, except percentages) |     |                    |     |                        |     |                        |     |
| United States              | \$ 3.2                            | 13% | \$ 6.2             | 21% | \$ 1.6                 | 12% | \$ 3.2                 | 23% |
| Europe and Middle East (1) | \$ 7.4                            | 30% | \$ 7.1             | 25% | \$ 3.4                 | 27% | \$ 3.4                 | 25% |
| Asia Pacific (2) (3) (4)   | \$ 14.3                           | 57% | \$ 15.4            | 54% | \$ 7.8                 | 61% | \$ 7.0                 | 52% |
| (1) Germany                | \$ 3.5                            | 14% | \$ 3.4             | 12% | \$ 1.8                 | 14% | \$ 1.6                 | 12% |
| (2) China                  | \$ 10.8                           | 43% | \$ 9.3             | 32% | \$ 6.8                 | 53% | \$ 4.1                 | 30% |
| (3) Japan                  | \$ *)                             | *)  | \$ 3.1             | 11% | \$ *)                  | *)  | \$ *)                  | *)  |
| (4) S. Korea               | \$ *)                             | *)  | \$ *)              | *)  | \$ *)                  | *)  | \$ 1.6                 | 12% |



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\*) Less than 10%

Due to the nature of our license agreements and the associated potential large individual contract amounts, the geographic split of revenues both in absolute dollars and percentage terms generally varies from quarter to quarter.

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Cost of revenues were \$1.1 million and \$2.7 million for the second quarter and first half of 2013, respectively, compared to \$1.0 million and \$1.9 million for the comparable periods of 2012. Cost of revenues accounted for 9% and 11% of our total revenues for the second quarter and first half of 2013, respectively, compared to 7% for both of the comparable periods of 2012. The slight increase for the second quarter of 2013 principally reflected higher customization work for our licensees. The increase for the first half of 2013 principally reflected higher customization work for our licensees and higher sub-contractors cost. Included in cost of revenues for the second quarter and first half of 2013 was non-cash equity-based compensation expense of \$81,000 and \$150,000, compared to \$53,000 and \$104,000 for the comparable periods of 2012.

*Gross Margin*

Gross margin for the second quarter and first half of 2013 were 91% and 89%, respectively, compared to 93% for both of the comparable periods of 2012. The decrease for the second quarter of 2013 mainly reflected lower royalty revenues which have higher gross margins. The decrease for the first half of 2013 mainly reflected lower royalty revenues which have higher gross margins and higher cost of revenues.

*Operating Expenses*

Total operating expenses were \$9.9 million and \$19.1 million for the second quarter and first half of 2013, respectively, compared to \$9.4 million and \$19.0 million for the comparable periods of 2012. The increase in total operating expenses for the second quarter of 2013 principally reflected higher project related expenses, lower research grants received from the Office of Chief Scientist of Israel, higher marketing and trade show expenses, and higher non-cash equity-based compensation expenses, partially offset by lower salary and related costs. The increase in total operating expenses for the first half of 2013 principally reflected higher project related expenses and higher non-cash equity-based compensation expenses, partially offset by lower salary and related costs.

*Research and Development Expenses, Net*

Our research and development expenses, net were \$5.6 million and \$10.7 million for the second quarter and first half of 2013, respectively, compared to \$5.4 million and \$10.9 million for the comparable periods of 2012. The net increase for the second quarter of 2013 principally reflected higher project related expenses, mainly as a result of an increase in design tool expenses, and lower research grants received from the Office of Chief Scientist of Israel, offset by lower salary and related costs partially as a result of cost allocation to cost of revenues for customization work. The net decrease for the first half of 2013 principally reflected lower salary and related costs partially as a result of cost allocation to cost of revenues for customization work and lower bonus provisions, partially offset by higher project related expenses mainly as a result of an increase in design tool expenses. Included in research and development expenses for the second quarter and first half of 2013 were non-cash equity-based compensation expenses of \$409,000 and \$855,000, respectively, compared to \$394,000 and \$859,000 for the comparable periods of 2012. Research and development expenses as a percentage of our total revenues were 44% and 43% for the second quarter and first half of 2013, respectively, compared to 40% and 38% for the comparable periods of 2012.

The number of research and development personnel was 125 at June 30, 2013, compared to 129 at June 30, 2012.

*Sales and Marketing Expenses*

Our sales and marketing expenses were \$2.5 million and \$4.9 million for the second quarter and first half of 2013, respectively, compared to \$2.1 million and \$4.4 million for the comparable periods of 2012. The increase for the second quarter of 2013 principally reflected higher salary and related costs, mainly due to higher headcount, higher marketing and trade show expenses, and higher non-cash equity-based compensation expenses. The increase for the first half of 2013 principally reflected higher salary and related costs, mainly due to higher headcount, and higher non-cash equity-based compensation expenses. Included in sales and marketing expenses for the second quarter and first half of 2013 were non-cash equity-based compensation expenses of \$332,000 and \$628,000, respectively, compared to \$200,000 and \$439,000 for the comparable periods of 2012. Sales and marketing expenses as a percentage of our total revenues were 20% for both the second quarter and first half of 2013, compared to 15% for both of the comparable periods of 2012.

The total number of sales and marketing personnel was 28 at June 30, 2013, compared to 24 at June 30, 2012.

*General and Administrative Expenses*

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Our general and administrative expenses were \$1.7 million and \$3.6 million for the second quarter and first half of 2013, respectively, compared to \$1.8 million and \$3.7 million for the comparable periods of 2012. The decrease for both the second quarter and first half of 2013 principally reflected lower salary and related costs mainly as a result of a lower bonus provisions, offset by

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higher non-cash equity-based compensation expenses. Included in general and administrative expenses for the second quarter and first half of 2013 were non-cash equity-based compensation expenses of \$524,000 and \$1,031,000, respectively, compared to \$430,000 and \$920,000 for the comparable periods of 2012. General and administrative expenses as a percentage of our total revenues were 14% for both the second quarter and first half of 2013, compared to 14% and 13% for the comparable periods of 2012.

The number of general and administrative personnel was 23 at June 30, 2013, compared to 24 at June 30, 2012.

**Financial Income, Net (in millions)**

|  | First Half<br>2013 | First Half<br>2012 | Second Quarter<br>2013 | Second Quarter<br>2012 |
|--|--------------------|--------------------|------------------------|------------------------|
| <b>Financial income, net</b>   | \$ 1.44            | \$ 1.92            | \$ 0.71                | \$ 0.97                |
| <i>of which:</i>   |                    |                    |                        |                        |
| Interest income and gains and losses from marketable securities, net | \$ 1.53            | \$ 1.89            | \$ 0.73                | \$ 0.92                |
| Foreign exchange gain (loss)   | \$ (0.09)          | \$ 0.03            | \$ (0.02)              | \$ 0.05                |

Financial income, net, consists of interest earned on investments, gains and losses from marketable securities, accretion (amortization) of discounts (premiums) on marketable securities and foreign exchange movements.

The decrease in interest income and gains and losses from marketable securities, net, during both the second quarter and first half of 2013 reflected less combined cash, bank deposits and marketable securities balances held and lower yields, offset by higher gains on sale of marketable securities.

We review our monthly expected major non-U.S. dollar denominated expenditures and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. This has resulted in a foreign exchange loss of \$0.02 million and \$0.09 million for the second quarter and first half of 2013, respectively, and a foreign exchange gain of \$0.05 million and \$0.03 million for the comparable periods of 2012.

**Provision for Income Taxes**

Our income tax expenses were \$0.3 million and \$0.7 million for the second quarter and first half of 2013, respectively, compared to \$0.7 million and \$1.4 million for the comparable periods of 2012. The decrease for the second quarter of 2013 primarily reflected less income before taxes on income. The decrease for the first half of 2013 primarily reflected less income before taxes on income, partially offset by a withholding tax income for which we obtained a refund from a certain tax authority in the first half of 2012. We have significant operations in Israel and operations in the Republic of Ireland, and a substantial portion of our taxable income is generated there. Currently, our Israeli and Irish subsidiaries are taxed at rates substantially lower than U.S. tax rates.

Our Irish subsidiary qualified for a 12.5% tax rate on its trade. Interest income generated by our Irish subsidiary is taxed at a rate of 25%.

Our Israeli subsidiary is entitled to various tax benefits by virtue of the Approved Enterprise and/or Benefited Enterprise status granted to its eight investment programs, as defined by the Israeli Investment Law. In accordance with the Investment Law, our Israeli subsidiary's first five investment programs were subject to corporate tax rate of 25% for the first half of 2013, and our Israeli subsidiary's sixth, seventh and eighth investment programs were subject to corporate tax rate of 10% for the first half of 2013. However, our Israeli subsidiary received an approval for the erosion of tax basis with respect to its second, third, fourth and fifth investment programs, and this resulted in an increase in the taxable income attributable to the sixth, seventh and eighth investment programs, which were subject to a reduced tax rate of 10% for the first half of 2013. The tax benefits under our Israeli subsidiary's active investment programs are scheduled to gradually expire starting in 2014.

To maintain our Israeli subsidiary's eligibility for the above tax benefits, it must continue to meet certain conditions under the Investment Law. Should our Israeli subsidiary fail to meet such conditions in the future, these benefits would be cancelled and it would be subject to corporate tax in Israel at the standard corporate rate and could be required to refund tax benefits already received, with interest and adjustments for inflation based on the Israeli consumer price index.

**Critical Accounting Policies and Estimates**

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Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

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We believe that the assumptions and estimates associated with revenue recognition, fair value of financial instruments, equity-based compensation and income taxes have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

See our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the SEC on March 15, 2013, for a discussion of additional critical accounting policies and estimates. There have been no changes in our critical accounting policies as compared to what was previously disclosed in the Form 10-K for the year ended December 31, 2012.

**LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2013, we had approximately \$7.5 million in cash and cash equivalents, \$39.4 million in short term bank deposits, \$79.3 million in marketable securities, and \$28.2 million in long term bank deposits, totaling \$154.4 million, compared to \$158.0 million at December 31, 2012. The decrease for the first half of 2013 principally reflected a share repurchase of \$4.9 million. During the first half of 2013, we invested \$77.3 million of cash in bank deposits and marketable securities with maturities up to 36 months. In addition, during the same period, bank deposits and marketable securities were sold or redeemed for cash amounting to \$69.4 million. All of our marketable securities are classified as available-for-sale. The purchase and sale or redemption of available-for-sale marketable securities are considered part of investing cash flow. Available-for-sale marketable securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of stockholders' equity, net of taxes. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the interim condensed consolidated statements of income. We did not recognize any other-than-temporarily-impaired charges on marketable securities during the first half of 2013. For more information about our marketable securities, see Notes 3 to the attached Notes to the Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2013.

Bank deposits are classified as short-term bank deposits and long-term bank deposits. Short-term bank deposits are deposits with maturities of more than three months but less than one year, whereas long-term bank deposits are deposits with maturities of more than one year. Bank deposits are presented at their cost, including accrued interest, and purchases and sales are considered part of cash flows from investing activities.

*Operating Activities*

Cash provided by operating activities for the first half of 2013 was \$1.4 million and consisted of net income of \$3.9 million, adjustments for non-cash items of \$2.8 million, and changes in operating assets and liabilities of \$5.3 million. Adjustments for non-cash items primarily consisted of \$3.0 million of depreciation and equity-based compensation expenses, \$0.2 million of realized gain, net on sale of available-for-sale marketable securities, \$0.8 million of amortization of premiums on available-for-sale marketable securities, and \$0.7 million of accrued interest on bank deposits. The decrease in cash from changes in operating assets and liabilities primarily consisted of an increase in trade receivables of \$3.0 million, an increase in prepaid expenses and other current assets of \$0.8 million, an increase in deferred taxes, net of \$0.5 million, a decrease in deferred revenues of \$0.3 million, a decrease in accrued expenses and other payables of \$0.8 million, and a decrease in accrued payroll and related benefits of \$0.6 million, partially offset by an increase in income tax payable of \$0.5 million.

Cash provided by operating activities for the first half of 2012 was \$9.8 million and consisted of net income of \$8.3 million, adjustments for non-cash items of \$2.2 million, and changes in operating assets and liabilities of \$0.7 million. Adjustments for non-cash items primarily consisted of \$2.6 million of depreciation and equity-based compensation expenses, \$0.8 million of amortization of premiums on available-for-sale marketable securities, and \$0.9 million of accrued interest on bank deposits. The decrease in cash from changes in operating assets and liabilities primarily consisted of an increase in deferred tax assets, net, of \$0.4 million, a decrease in accrued expenses and other payables of \$0.3 million, a decrease in accrued payroll and related benefits of \$1.6 million, and a classification of excess tax benefit from equity-based compensation expenses of \$0.8 million as financing cash flows, partially offset by a decrease in trade receivables of \$0.4 million, a decrease in prepaid expenses and other accounts receivable of \$0.6 million, an increase in trade payables of \$0.4 million and an increase in income taxes payable of \$1.0 million.

Cash flows from operating activities may vary significantly from quarter to quarter depending on the timing of our receipts and payments. Our ongoing cash outflows from operating activities principally relate to payroll-related costs and obligations under our property leases and design tool licenses. Our primary sources of cash inflows are receipts from our accounts receivable and interest earned from our cash and marketable securities. The timing of receipts of accounts receivable from customers is based upon the completion of agreed milestones or agreed dates as set out in the contracts.



**Table of Contents***Investing Activities*

Net cash used in investing activities for the first half of 2013 was \$8.8 million, compared to \$14.9 million of net cash provided by investing activities for the comparable period of 2012. We had a cash outflow of \$46.3 million and a cash inflow of \$34.9 million in respect of investments in marketable securities during the first half of 2013, as compared to cash outflow of \$20.4 million and a cash inflow of \$35.0 million in respect of investments in marketable securities during the first half of 2012. For the first half of 2013, we had net proceeds of \$3.5 million from bank deposits, as compared to net proceeds of \$0.5 million from bank deposits for the comparable period of 2012. We had a cash outflow of \$0.3 million during the first half of 2013 from minority investment in a private company. We had a cash outflow of \$0.6 million and \$0.2 million during the first half of 2013 and 2012, respectively, from purchase of property and equipment.

*Financing Activities*

Net cash used in financing activities for the first half of 2013 was \$3.4 million, compared to \$19.2 million of net cash used in financing activities for the comparable period of 2012.

In January 2012, our Board of Directors reaffirmed its authorization for the repurchase by the company of 1,966,700 shares of common stock pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, as amended. During the first half of 2013, we repurchased 304,738 shares of common stock pursuant to our share repurchase program, at an average purchase price of \$15.92 per share, for an aggregate purchase price of \$4.9 million. During the first half of 2012, we repurchased 1,066,742 shares of common stock pursuant to our share repurchase program, at an average purchase price of \$19.49 per share, for an aggregate purchase price of \$20.8 million. In July 2013, our Board of Directors authorized the repurchase of an additional 2,000,000 shares of our common stock pursuant to Rule 10b-18 of the Exchange Act.

During the first half of 2013, we received \$1.4 million from the exercises of stock-based awards, as compared to \$0.9 million received for the comparable period of 2012. During the first half of 2012, we classified \$0.8 million of excess tax benefit from equity-based compensation expenses as financing cash flows.

We believe that our current cash on hand, short-term deposits and marketable securities, along with cash from operations, will provide sufficient capital to fund our operations for at least the next 12 months. We cannot provide assurances, however, that the underlying assumed levels of revenues and expenses will prove to be accurate.

In addition, as part of our business strategy, we occasionally evaluate potential acquisitions of businesses, products and technologies and minority equity investments. Accordingly, a portion of our available cash may be used at any time for the acquisition of complementary products or businesses or minority equity investments. Such potential transactions may require substantial capital resources, which may require us to seek additional debt or equity financing. We cannot assure you that we will be able to successfully identify suitable acquisition or investment candidates, complete acquisitions or investments, integrate acquired businesses into our current operations, or expand into new markets. Furthermore, we cannot provide assurances that additional financing will be available to us in any required time frame and on commercially reasonable terms, if at all. See **Risk Factors** We may seek to expand our business in ways that could result in diversion of resources and extra expenses. for more detailed information.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A majority of our revenues and a portion of our expenses are transacted in U.S. dollars and our assets and liabilities together with our cash holdings are predominately denominated in U.S. dollars. However, the majority of our expenses are denominated in currencies other than the U.S. dollar, principally the NIS, and in some extent the Euro and the British Pound. Increases in volatility of the exchange rates of currencies other than the U.S. dollar versus the U.S. dollar could have an adverse effect on the expenses and liabilities that we incur when remeasured into U.S. dollars. We review our monthly expected non-U.S. dollar denominated expenditures and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. This has resulted in a foreign exchange loss of \$17,000 and \$85,000 for the second quarter and first half of 2013, respectively, and a foreign exchange gain of \$52,000 and \$34,000 for the comparable periods of 2012. The foreign exchange losses arose principally on the Euro and the NIS assets and liabilities as a result of the currency fluctuations of the Euro and the NIS against the U.S. dollar.

As a result of currency fluctuations and the remeasurement of non-U.S. dollar denominated expenditures to U.S. dollars for financial reporting purposes, we may experience fluctuations in our operating results on an annual and quarterly basis. To protect against the increase in value of forecasted foreign currency cash flow resulting from salaries paid in currencies other than the U.S. dollar during the year, we follow a foreign currency cash flow hedging program. We hedge portions of the anticipated payroll for our non-U.S. employees denominated in currencies other



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than the U.S. dollar for a period of one to twelve months with forward and option contracts. During the second quarter and first half of 2013, we recorded accumulated other comprehensive loss of \$68,000 and \$66,000, respectively, from our forward and option contracts, net of taxes, with respect to anticipated payroll expenses for our non-U.S. employees. During the second quarter and first half of 2012, we recorded accumulated other comprehensive loss of \$171,000 and

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accumulated other comprehensive gain of \$76,000, respectively, from our forward and option contracts, net of taxes, with respect to anticipated payroll expenses for our non-U.S. employees. As of June 30, 2013, the amount of other comprehensive gain from our forward and option contracts, net of taxes, was \$128,000, which will be recorded in the consolidated statements of income during the following 6 months. We recognized a net gain of \$188,000 and \$288,000 for the second quarter and first half of 2013, respectively, and a net loss of \$83,000 and \$140,000 for the comparable periods of 2012, related to forward and options contracts. We note that hedging transactions may not successfully mitigate losses caused by currency fluctuations. We expect to continue to experience the effect of exchange rate and currency fluctuations on an annual and quarterly basis.

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

We hold an investment portfolio consisting principally of corporate bonds. We intend, and have the ability, to hold such investments until recovery of temporary declines in market value or maturity. Accordingly, as of June 30, 2013, we believe the losses associated with our investments are temporary and no impairment loss was recognized during the first half of 2013. However, we can provide no assurance that we will recover present declines in the market value of our investments.

Interest income and gains and losses from marketable securities, net, were \$0.73 million and \$1.53 million for the second quarter and first half of 2013, respectively compared to \$0.92 million and \$1.89 million for the comparable periods of 2012. The decrease in interest income and gains and losses from marketable securities, net, during the second quarter and first half of 2013 principally reflected less combined cash, bank deposits and marketable securities balances held and lower yields, offset by higher gains on sale of marketable securities.

We are exposed primarily to fluctuations in the level of U.S., Israeli and EMU (European Monetary Union) interest rates. To the extent that interest rates rise, fixed interest investments may be adversely impacted, whereas a decline in interest rates may decrease the anticipated interest income for variable rate investments. We typically do not attempt to reduce or eliminate our market exposures on our investment securities because the majority of our investments are short-term. We currently do not have any derivative instruments but may put them in place in the future. Fluctuations in interest rates within our investment portfolio have not had, and we do not currently anticipate such fluctuations will have, a material effect on our financial position on an annual or quarterly basis.

**Item 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2013.

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

**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

We are not a party to any litigation or other legal proceedings that we believe could reasonably be expected to have a material effect on our business, results of operations and financial condition.

**Item 1A. RISK FACTORS**

*This Form 10-Q contains forward-looking statements concerning our future products, expenses, revenue, liquidity and cash needs as well as our plans and strategies. These forward-looking statements are based on current expectations and we assume no obligation to update this information. Numerous factors could cause our actual results to differ significantly from the results described in these forward-looking statements, including the following risk factors.*

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There are no material changes to the Risk Factors described under the title "Factors That May Affect Future Performance" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 other than (1) changes to the Risk Factor below entitled: "The markets in which we operate are highly competitive, and as a result we could experience a loss of sales, lower prices and lower revenue;" (2) changes to the Risk Factor below entitled "One quarterly operating results fluctuate from quarter to quarter due to a variety of factors, including our lengthy sales cycle, and may not be a meaningful indicator of future performance;" (3) changes to the Risk Factor below entitled: "We rely significantly on revenue derived from a limited number of customers;" (4) changes to the Risk Factor below entitled "Royalty rates could decrease for existing and future license agreements which could materially adversely affect our operating results;" (5) changes to the Risk Factor below entitled "We generate a significant amount of our total revenues from the handsets and mobile broadband markets and our business and operating results may be materially adversely affected if we do not continue to succeed in these highly competitive markets;" (6) changes to the Risk Factor below entitled "Because we have significant international operations, we may be subject to political, economic and other conditions relating to our international operations that could increase our operating expenses and disrupt our revenues and business;" (7) changes to the Risk Factor below entitled "Our research and development expenses may increase if the grants we currently receive from the Israeli government are reduced or withheld;" (8) changes to the Risk Factor below entitled "Our product development efforts are time-consuming and expensive and may not generate an acceptable return, if any."

### **The markets in which we operate are highly competitive, and as a result we could experience a loss of sales, lower prices and lower revenue.**

The markets for the products in which our technology is incorporated are highly competitive. Aggressive competition could result in substantial declines in the prices that we are able to charge for our intellectual property. Many of our competitors are striving to increase their share of the growing DSP market and are reducing their licensing and royalty fees to attract customers. The following industry players and factors may have a significant impact on our competitiveness:

we compete directly in the DSP cores space with Verisilicon;

we compete with CPU IP or configurable CPU IP (offering DSP configured CPU and/or DSP extensions to their IP) providers, such as ARM Holdings, Imagination Technologies (resulting from its acquisition of MIPS Technologies), Synopsys and Cadence (resulting from its acquisition of Tensilica);

we compete with internal engineering teams at companies such as Broadcom, Mediatek, Qualcomm, Samsung and ST Ericsson that may design programmable DSP core products in-house and therefore not license our technologies;

we compete in the SATA and SAS IP markets with several vendors, such as Gennum's Snowbush IP group, Silicon Image and Synopsys, that offer similar products, thereby leading to pricing pressures for both licensing and royalty revenue;

we compete in the digital photography & embedded vision market with Cadence and GPU IP providers such as ARM, Imagination Technologies, and Vivante;

we compete in the VoIP applications market with ARM Holdings, Imagination Technologies and Verisilicon; and

we compete in the audio applications market with ARM Holdings, Synopsys, Cadence and Verisilicon.

In addition, we may face increased competition from smaller, niche semiconductor design companies in the future. Some of our customers also may decide to satisfy their needs through in-house design. We compete on the basis of DSP performance, overall chip cost, power consumption, flexibility, reliability, communication and multimedia software availability, design cycle time, tool chain, customer support, name recognition, reputation and financial strength. Our inability to compete effectively on these bases could have a material adverse effect on our business, results of operations and financial condition.

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**Our quarterly operating results fluctuate from quarter to quarter due to a variety of factors, including our lengthy sales cycle, and may not be a meaningful indicator of future performance.**

In some quarters our operating results could be below the expectations of securities analysts and investors, which could cause our stock price to fall. Factors that may affect our quarterly results of operations in the future include, among other things:

the gain or loss of significant licensees, partly due to our dependence on a limited number of customers generating a significant amount of quarterly revenues;

any delay in execution of any anticipated licensing arrangement during a particular quarter;

delays in revenue recognition for some license agreements based on percentage of completion of customized work;

the timing and volume of orders and production by our customers, as well as fluctuations in royalty revenues resulting from fluctuations in unit shipments by our licensees;

royalty pricing pressures and reduction in royalty rates due to an increase in volume shipments by customers, end-product price erosion and competitive pressures;

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earnings or other financial announcements by our major customers that include shipment data or other information that implicates expectations for our future royalty revenues;

the mix of revenues among licensing and related revenues, and royalty revenues;

the timing of the introduction of new or enhanced technologies by us and our competitors, as well as the market acceptance of such technologies;

our lengthy sales cycle and specifically in the third quarter of any fiscal year during which summer vacations slow down decision-making processes of our customers in executing contracts;

delays in the commercialization of end products that incorporate our technology;

currency fluctuations of the Euro, the British Pound and NIS versus the U.S. dollar;

fluctuations in operating expenses and gross margins associated with the introduction of new or enhanced technologies and adjustments to operating expenses resulting from restructurings;

the timing of certain R&D government grant payments;

our ability to scale our operations in response to changes in demand for our technologies;

entry into new markets, including China, India and Latin America;

changes in our pricing policies and those of our competitors;

restructuring, asset and goodwill impairment and related charges, as well as other accounting changes or adjustments; and

general economic conditions, including the current economic conditions, and its effect on the semiconductor industry and sales of consumer products into which our technologies are incorporated.

Each of the above factors is difficult to forecast and could harm our business, financial condition and results of operations. Also, we license our technology to OEMs and semiconductor companies for incorporation into their end products for consumer markets, including handsets and consumer electronics products. The royalties we generate are reported by our customers and invoiced by us one quarter in arrears. As a result, our royalty revenues are affected by seasonal buying patterns of consumer products sold by our OEM customers that incorporate our technology and the market acceptance of such end products supplied by our OEM customers.

Moreover, the semiconductor and consumer electronics industries remain volatile, which makes it extremely difficult for our customers and us to accurately forecast financial results and plan for future business activities. As a result, our past operating results should not be relied upon as an indication of future performance.

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

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We derive a significant amount of revenues from a limited number of customers. Two customers separately accounted for 47% and 14% of our total revenues for the second quarter of 2013. Two customers separately accounted for 32% and 14% of our total revenues for the first half of 2013. Generally, the identity of our customers representing 10% or more of our total revenues varies from period to period, especially with respect to our licensing customers as we generate licensing revenues generally from new customers on a quarterly and annual basis. With respect to our royalty revenues, four royalty paying customers each represented 10% or more of our total royalty revenues for the second quarter and first half of 2013 and collectively represented 86% and 82% of our total royalty revenues for the second quarter and first half of 2013, respectively. We expect that a significant portion of our future royalty revenue will continue to be generated by a limited number of customers. The loss of any significant royalty paying customer could adversely affect our near-term future operating results. Furthermore, consolidation among our customers may negatively affect our revenue source, increase our existing customers' negotiation leverage and make us further dependent on a limited number of customers.

### **Our business is dependent on licensing revenue which may vary period to period.**

License agreements for our DSP cores have not historically provided for substantial ongoing license payments so past licensing revenue may not be indicative of the amount of such revenue in any future period. Significant portions of our anticipated future revenue, therefore, will likely depend upon our success in attracting new customers or expanding our relationships with existing customers. However, revenue recognized from licensing arrangements vary significantly from period to period, depending on the number and size of deals closed during a quarter, and is difficult to predict. Our ability to succeed in our licensing efforts will depend on a variety of factors, including the performance, quality, breadth and depth of our current and future products, as well as our sales and marketing skills. In addition, some of our licensees may in the future decide to satisfy their needs through in-house design and production. Our failure to obtain future licensing customers would impede our future revenue growth and could materially harm our business.

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### **Royalty rates could decrease for existing and future license agreements which could materially adversely affect our operating results.**

Royalty payments to us under existing and future license agreements could be lower than currently anticipated for a variety of reasons. Average selling prices for semiconductor products generally decrease over time during the lifespan of a product. In addition, there is increasing downward pricing pressures in the semiconductor industry on end products incorporating our technology, especially end products for the handsets and consumer electronics markets. As a result, notwithstanding the existence of a license agreement, our customers may demand that royalty rates for our products be lower than our historic royalty rates. We have in the past and may be pressured in the future to renegotiate existing license agreements with our customers. In addition, certain of our license agreements provide that royalty rates may decrease in connection with the sale of larger quantities of products incorporating our technology. Furthermore, our competitors may lower the royalty rates for their comparable products to win market share which may force us to lower our royalty rates as well. As a consequence of the above referenced factors, as well as unforeseen factors in the future, the royalty rates we receive for use of our technology could decrease, thereby decreasing future anticipated revenue and cash flow. Royalty revenues were approximately 52% and 55% of our total revenues for the second quarter and first half of 2013, respectively. Therefore, a significant decrease in our royalty revenues could materially adversely affect our operating results.

Moreover, royalty rates may be negatively affected by macroeconomic trends. For example, our royalty revenue decreased in 2012 in connection with a significant decline in the average selling prices of low-cost 2G feature phones. Furthermore, consolidation among our customers may increase the leverage of our existing customers to extract concessions from us in royalty rates.

### **We generate a significant amount of our total revenues from the handsets and mobile broadband markets and our business and operating results may be materially adversely affected if we do not continue to succeed in these highly competitive markets.**

Revenues derived from the handsets and mobile broadband markets accounted for approximately 85% and 83% of our total revenues for the second quarter and first half of 2013, respectively. A significant portion of such revenues from the handsets and mobile broadband markets is derived from 2G handsets. Although next generation products generally have higher average selling prices and our royalty revenues from 3G handsets exceeded royalty revenues from 2G handsets for the first time during the second quarter of 2013, we can provide no assurances that this trend will continue or that we will be successful in offsetting any decline in revenues from 2G handsets with increased revenues from next generation products such as 3G and LTE handsets. Any adverse change in our ability to compete and maintain our competitive position in the handsets and mobile broadband markets, including through the introduction by competitors of enhanced technologies that attract OEM customers that target these markets, would harm our business, financial condition and results of operations. Moreover, the handsets and mobile broadband markets are extremely competitive and are facing intense pricing pressures, and we expect that competition and pricing pressures will only increase. Furthermore, the handset and mobile markets can be very volatile with regards to volume shipments of different phones, standards and connected devices due to inventory build out or consumer demand changes or geographical macroeconomics, pricing changes and timing of introduction of new phones and products. For example, our royalty revenue decreased in 2012 in connection with a significant decline in the average selling prices of low-cost 2G feature phones. Our existing OEM customers also may fail to introduce new handsets or mobile broadband devices that attract consumers, or encounter significant delays in developing, manufacturing or shipping new or enhanced products in these markets. The inability of our OEM customers to compete would result in lower shipments of products powered by our technologies which in turn would have a material adverse effect on our business, financial condition and results of operations.

According to the latest research from Gartner, 2012 global mobile phone sales declined by 1.7% year-on-year, from 1.78 billion to 1.75 billion. The last time Gartner reported a decline was in 2009. Since a significant portion of our revenues are derived from the handset market, adverse conditions in this market would have a material adverse effect on our business, financial condition and results of operations.

### **Because our IP solutions are components of end products, if semiconductor companies and electronic equipment manufacturers do not incorporate our solutions into their end products or if the end products of our customers do not achieve market acceptance, we may not be able to generate adequate sales of our products.**

We do not sell our IP solutions directly to end-users; we license our technology primarily to semiconductor companies and electronic equipment manufacturers, who then incorporate our technology into the products they sell. As a result, we rely on our customers to incorporate our technology into their end products at the design stage. Once a company incorporates a competitor's technology into its end product, it becomes significantly more difficult for us to sell our technology to that company because changing suppliers involves significant cost, time, effort and risk for the company. As a result, we may incur significant expenditures on the development of a new technology without any assurance that our existing or potential customers will select our technology for incorporation into their own product and without this design win, it becomes significantly difficult to sell our IP solutions. Moreover, even after a customer agrees to incorporate our technology into its end products, the design cycle is long and may be





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delayed due to factors beyond our control, which may result in the end product incorporating our technology not reaching the market until long after the initial design win with such customer. From initial product design-in to volume production, many factors could impact the timing and/or amount of sales actually realized from the design-in. These factors include, but are not limited to, changes in the competitive position of our technology, our customers' financial stability, and our ability to ship products according to our customers' schedule. Moreover, current economic conditions may further prolong a customer's decision-making process and design cycle.

Further, because we do not control the business practices of our customers, we do not influence the degree to which they promote our technology or set the prices at which they sell products incorporating our technology. We cannot assure you that our customers will devote satisfactory efforts to promote our IP solutions.

In addition, our royalties from licenses and therefore the growth of our business, are dependent upon the success of our customers in introducing products incorporating our technology and the success of those products in the marketplace. The primary customers for our products are semiconductor design and manufacturing companies, system OEMs and electronic equipment manufacturers, particularly in the telecommunications field. These industries are highly competitive, cyclical and have been subject to significant economic downturns at various times. These downturns are characterized by production overcapacity and reduced revenues, which at times may encourage semiconductor companies or electronic product manufacturers to reduce their expenditure on our technology. If we do not retain our current customers and continue to attract new customers, our business may be harmed.

### **We depend on market acceptance of third-party semiconductor intellectual property.**

The semiconductor intellectual property (SIP) industry is a relatively small and emerging industry. Our future growth will depend on the level of market acceptance of our third-party licensable intellectual property model, the variety of intellectual property offerings available on the market, and a shift in customer preference away from in-house development of proprietary DSPs towards licensing open DSP cores. Furthermore, the third-party licensable intellectual property model is highly dependent on the market adoption of new services and products, such as smartphones, mobile broadband, ultra-low-cost phones in emerging markets, Personal Multimedia Players (PMP), Blu-ray DVDs, connected digital TVs and set-top boxes with high definition audio and video. Such market adoption is important because the increased cost associated with ownership and maintenance of the more complex architectures needed for the advanced services and products may motivate companies to license third-party intellectual property rather than design them in-house.

The trends that would enable our growth are largely beyond our control. Semiconductor customers also may choose to adopt a multi-chip, off-the-shelf chip solution versus licensing or using highly-integrated chipsets that embed our technologies. If the above referenced market shifts do not materialize or third-party SIP does not achieve market acceptance, our business, results of operations and financial condition could be materially harmed.

### **Because we have significant international operations, we may be subject to political, economic and other conditions relating to our international operations that could increase our operating expenses and disrupt our revenues and business.**

Approximately 87% of our total revenues for the first half of 2013 were derived from customers located outside of the United States. We expect that international customers will continue to account for a significant portion of our revenue for the foreseeable future. As a result, the occurrence of any negative international political, economic or geographic events could result in significant revenue shortfalls. These shortfalls could cause our business, financial condition and results of operations to be harmed. Some of the risks of doing business internationally include:

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, treaties and technical standards;

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uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property;

multiple and possibly overlapping tax structures and potentially adverse tax consequences;

political and economic instability; and

changes in diplomatic and trade relationships.

**We depend on a limited number of key personnel who would be difficult to replace.**

Our success depends to a significant extent upon certain of our key employees and senior management, the loss of which could materially harm our business. Competition for skilled employees in our field is intense. We cannot assure you that in the future we will be successful in attracting and retaining the required personnel.

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### **The sales cycle for our IP solutions is lengthy, which makes forecasting of our customer orders and revenues difficult.**

The sales cycle for our IP solutions is lengthy, often lasting three to nine months. Our customers generally conduct significant technical evaluations, including customer trials, of our technology as well as competing technologies prior to making a purchasing decision. In addition, purchasing decisions also may be delayed because of a customer's internal budget approval process. Furthermore, given the current market conditions, we have less ability to predict the timing of our customers' purchasing cycle and potential unexpected delays in such a cycle. Because of the lengthy sales cycle and potential delays, our dependence on a limited number of customers to generate a significant amount of revenues for a particular period and the size of customer orders, if orders forecasted for a specific customer for a particular period do not occur in that period, our revenues and operating results for that particular quarter could suffer. Moreover, a portion of our expenses related to an anticipated order is fixed and difficult to reduce or change, which may further impact our operating results for a particular period.

### **Because our IP solutions are complex, the detection of errors in our products may be delayed, and if we deliver products with defects, our credibility will be harmed, the sales and market acceptance of our products may decrease and product liability claims may be made against us.**

Our IP solutions are complex and may contain errors, defects and bugs when introduced. If we deliver products with errors, defects or bugs, our credibility and the market acceptance and sales of our products could be significantly harmed. Furthermore, the nature of our products may also delay the detection of any such error or defect. If our products contain errors, defects and bugs, then we may be required to expend significant capital and resources to alleviate these problems. This could result in the diversion of technical and other resources from our other development efforts. Any actual or perceived problems or delays may also adversely affect our ability to attract or retain customers. Furthermore, the existence of any defects, errors or failure in our products could lead to product liability claims or lawsuits against us or against our customers. A successful product liability claim could result in substantial cost and divert management's attention and resources, which would have a negative impact on our financial condition and results of operations.

### **Our operating results are affected by general economic conditions and the highly cyclical nature of the semiconductor industry.**

During the global downturn that started in the second half of 2008 and continued throughout 2009, general worldwide economic conditions significantly deteriorated, and resulted in decreased consumer confidence and spending, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Notwithstanding improvements in business conditions since the second half of 2009, there continues to be uncertainty about the global economy and outlook, which continue to make it difficult for our customers, the end-product customers, our vendors and us to accurately forecast and plan future business activities and make reliable projections.

Moreover, we operate within the semiconductor industry which experiences significant fluctuations in sales and profitability. Downturns in the semiconductor industry are characterized by diminished product demand, excess customer inventories, accelerated erosion of prices and excess production capacity. These factors could cause substantial fluctuations in our revenues and in our results of operations.

If global economic and market conditions remain uncertain or deteriorate, we could experience a material adverse impact on our business and results of operations.

### **Our success will depend on our ability to successfully manage our geographically dispersed operations.**

Most of our employees are located in Israel and Ireland. Accordingly, our ability to compete successfully will depend in part on the ability of a limited number of key executives located in geographically dispersed offices to integrate management, address the needs of our customers and respond to changes in our markets. If we are unable to effectively manage and integrate our remote operations, our business may be materially harmed.

### **Our operations in Israel may be adversely affected by instability in the Middle East region.**

One of our principal research and development facilities is located in Israel, and our executive officers and some of our directors are residents of Israel. Although substantially all of our sales currently are being made to customers outside Israel, we are nonetheless directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel could significantly harm our business, operating results and financial condition.

In addition, certain of our employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called to active military duty at any time. Although we have operated effectively under these requirements since our inception, we cannot predict the effect of these obligations on the company in the future. Our operations could be disrupted by the absence, for a significant period, of one or

more of our key employees due to military service.

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**Our research and development expenses may increase if the grants we currently receive from the Israeli government are reduced or withheld.**

We currently receive research grants from programs of the Office of the Chief Scientist of Israel of the Israeli Ministry of Industry and Trade. We received an aggregate of \$499,000 for the first half of 2013. To be eligible for these grants, we must meet certain development conditions and comply with periodic reporting obligations. Although we have met such conditions in the past, should we fail to meet such conditions in the future our research grants may be repayable, reduced or withheld. The repayment or reduction of such research grants may increase our research and development expenses which in turn may reduce our operating income.

**We are exposed to fluctuations in currency exchange rates.**

A significant portion of our business is conducted outside the United States. Although most of our revenue is transacted in U.S. dollars, we may be exposed to currency exchange fluctuations in the future as business practices evolve and we are forced to transact business in local currencies. Moreover, the majority of our expenses are denominated in foreign currencies, mainly New Israeli Shekel (NIS), and to some extent Euro and British Pound, which subjects us to the risks of foreign currency fluctuations. Our primary expenses paid in currencies other than the U.S. dollar are employee salaries. Increases in the volatility of the exchange rates of currencies other than the U.S. dollar versus the U.S. dollar could have an adverse effect on the expenses and liabilities that we incur in currencies other than the U.S. dollar when remeasured into U.S. dollars for financial reporting purposes. We have instituted a foreign cash flow hedging program to minimize the effects of currency fluctuations. However, hedging transactions may not successfully mitigate losses caused by currency fluctuations, and our hedging positions may be partial or may not exist at all in the future. We also review our monthly expected non-U.S. dollar denominated expenditure and look to hold equivalent non-U.S. dollar cash balances to mitigate currency fluctuations. We expect to continue to experience the effect of exchange rate currency fluctuations on an annual and quarterly basis.

**Our product development efforts are time-consuming and expensive and may not generate an acceptable return, if any.**

Our product development efforts require us to incur substantial research and development expense. Our research and development expenses were approximately \$10.7 million for the first half of 2013. We may not be able to achieve an acceptable return, if any, on our research and development efforts.

The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Furthermore, we may expend significant amounts on research and development programs that may not ultimately result in commercially successful products. As a result of these and other factors, we may be unable to develop and introduce new products successfully and in a cost-effective and timely manner, and any new products we develop and offer may never achieve market acceptance. Any failure to successfully develop future products would have a material adverse effect on our business, financial condition and results of operations.

**If we are unable to meet the changing needs of our end-users or address evolving market demands, our business may be harmed.**

The markets for programmable DSP cores and application IP are characterized by rapidly changing technology, emerging markets and new and developing end-user needs, and requiring significant expenditure for research and development. We cannot assure you that we will be able to introduce systems and solutions that reflect prevailing industry standards, on a timely basis, meet the specific technical requirements of our end-users or avoid significant losses due to rapid decreases in market prices of our products, and our failure to do so may seriously harm our business.

**We may seek to expand our business in ways that could result in diversion of resources and extra expenses.**

We may in the future pursue acquisitions of businesses, products and technologies, establish joint venture arrangements, make minority equity investments or enhance our existing CEVAnet partner eco-system to expand our business. We are unable to predict whether or when any prospective acquisition, equity investment or joint venture will be completed. The process of negotiating potential acquisitions, joint ventures or equity investments, as well as the integration of acquired or jointly developed businesses, technologies or products may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management's attention. We cannot assure you that we will be able to successfully identify suitable acquisition or investment



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candidates, complete acquisitions or investments, or integrate acquired businesses or joint ventures with our operations. If we were to make any acquisition or investment or enter into a joint venture, we may not receive the intended benefits of the acquisition, investment or joint venture or such an acquisition, investment or joint venture may not achieve comparable levels of revenues, profitability or productivity as our existing business or otherwise perform as expected. The expansion of our CEVAnet partner eco-system also may not achieve the anticipated benefits. The occurrence of any of these events could harm our business, financial condition or results of operations. Future acquisitions, investments or joint ventures may require substantial capital resources, which may require us to seek additional debt or equity financing.

Future acquisitions, joint ventures or minority equity investments by us could result in the following, any of which could seriously harm our results of operations or the price of our stock:

issuance of equity securities that would dilute our current stockholders' percentages of ownership;

large one-time write-offs or equity investment impairment write-offs;

incurrence of debt and contingent liabilities;

difficulties in the assimilation and integration of operations, personnel, technologies, products and information systems of the acquired companies;

diversion of management's attention from other business concerns;

contractual disputes;

risks of entering geographic and business markets in which we have no or only limited prior experience; and

potential loss of key employees of acquired organizations.

### **We may not be able to adequately protect our intellectual property.**

Our success and ability to compete depend in large part upon the protection of our proprietary technologies. We rely on a combination of patent, copyright, trademark, trade secret, mask work and other intellectual property rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement or protect us from the claims of others. As a result, we face risks associated with our patent position, including the potential need to engage in significant legal proceedings to enforce our patents, the possibility that the validity or enforceability of our patents may be denied, the possibility that third parties will be able to compete against us without infringing our patents and the possibility that our products may infringe patent rights of third parties.

Our trade names or trademarks may be registered or utilized by third parties in countries other than those in which we have registered them, impairing our ability to enter and compete in these markets. If we were forced to change any of our brand names, we could lose a significant amount of our brand identity.

### **Our business will suffer if we are sued for infringement of the intellectual property rights of third parties or if we cannot obtain licenses to these rights on commercially acceptable terms.**



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We are subject to the risk of adverse claims and litigation alleging infringement of the intellectual property rights of others. There are a large number of patents held by others, including our competitors, pertaining to the broad areas in which we are active. We have not, and cannot reasonably, investigate all such patents. From time to time, we have become aware of patents in our technology areas and have sought legal counsel regarding the validity of such patents and their impact on how we operate our business, and we will continue to seek such counsel when appropriate in the future. In addition, patent infringement claims are increasingly being asserted by patent holding companies (so-called patent trolls), which do not use technology and whose sole business is to enforce patents against companies, such as us, for monetary gain. Because such patent holding companies do not provide services or use technology, the assertion of our own patents by way of counter-claim may be ineffective. Infringement claims may require us to enter into license arrangements or result in protracted and costly litigation, regardless of the merits of these claims. Any necessary licenses may not be available or, if available, may not be obtainable on commercially reasonable terms. If we cannot obtain necessary licenses on commercially reasonable terms, we may be forced to stop licensing our technology, and our business would be seriously harmed.

### **Our business depends on our customers and their suppliers obtaining required complementary components.**

Some of the raw materials, components and subassemblies included in the products manufactured by our OEM customers 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 products containing our IP, especially our DSP cores, until those necessary components are available.

**Table of Contents****The future growth of our business depends in part on our ability to license to system OEMs and small-to-medium-sized semiconductor companies directly and to expand our sales geographically.**

Historically, a substantial portion of our licensing revenues has been derived in any given period from a relatively small number of licensees. Because of the substantial license fees we charge, our customers tend to be large semiconductor companies or vertically integrated system OEMs. Part of our current growth strategy is to broaden the adoption of our products by small and mid-size companies by offering different versions of our products targeted at these companies. If we are unable to develop and market effectively our intellectual property through these models, our revenues will continue to be dependent on a smaller number of licensees and a less geographically dispersed pattern of licensees, which could materially harm our business and results of operations.

**The Israeli tax benefits that we currently receive and the government programs in which we participate require us to meet certain conditions and may be terminated or reduced in the future, which could increase our tax expenses.**

We enjoy certain tax benefits in Israel, particularly as a result of the *Approved Enterprise* and the *Benefited Enterprise* status of our facilities and programs. To maintain our eligibility for these tax benefits, we must continue to meet certain conditions, relating principally to adherence to the investment program filed with the Investment Center of the Israeli Ministry of Industry and Trade and to periodic reporting obligations. Should we fail to meet such conditions in the future, these benefits would be cancelled and we would be subject to corporate tax in Israel at the standard corporate rate (25% in 2013) and could be required to refund tax benefits already received. In addition, we cannot assure you that these tax benefits will be continued in the future at their current levels or otherwise. The tax benefits under our active investment programs are scheduled to gradually expire starting in 2014. The termination or reduction of certain programs and tax benefits (particularly benefits available to us as a result of the *Approved Enterprise* and the *Benefited Enterprise* status of our facilities and programs) or a requirement to refund tax benefits already received may seriously harm our business, operating results and financial condition.

**We may dispose of or discontinue existing product lines and technology developments, which may adversely impact our future results.**

On an ongoing basis, we evaluate our various product offerings and technology developments in order to determine whether any should be discontinued or, to the extent possible, divested. We cannot guarantee that we have correctly forecasted, or will correctly forecast in the future, the right product lines and technology developments to dispose or discontinue or that our decision to dispose of or discontinue various investments, products lines and technology developments is prudent if market conditions change. In addition, there are no assurances that the discontinuance of various product lines will reduce our operating expenses or will not cause us to incur material charges associated with such decision. Furthermore, the discontinuance of existing product lines entails various risks, including the risk that we will not be able to find a purchaser for a product line or the purchase price obtained will not be equal to at least the book value of the net assets for the product line. Other risks include managing the expectations of, and maintaining good relations with, our customers who previously purchased products from our disposed or discontinued product lines, which could prevent us from selling other products to them in the future. We may also incur other significant liabilities and costs associated with our disposal or discontinuance of product lines, including employee severance costs and excess facilities costs.

**Our corporate tax rate may increase, which could adversely impact our cash flow, financial condition and results of operations.**

We have significant operations in Israel, as well operations in the Republic of Ireland and a substantial portion of our taxable income historically has been generated there. Currently, some of our Israeli and Irish subsidiaries are taxed at rates substantially lower than the U.S. tax rates. If our Israeli and Irish subsidiaries were no longer to qualify for these lower tax rates or if the applicable tax laws were rescinded or changed, our operating results could be materially adversely affected. In addition, because our Israeli and Irish operations are owned by subsidiaries of our U.S. parent corporation, distributions to the U.S. parent corporation, and in certain circumstances undistributed income of the subsidiaries, may be subject to U.S. taxes. Moreover, if U.S. or other authorities were to change applicable tax laws or successfully challenge the manner in which our subsidiaries' profits are currently recognized, our overall tax expenses could increase, and our business, cash flow, financial condition and results of operations could be materially adversely affected. Also our taxes on the Irish interest income may be double taxed both in Ireland and in the U.S. due to U.S. tax regulations and Irish tax restrictions on NOLs to off-set interest income. In addition, starting in 2012, our Israeli interest income also may be double taxed both in Israel and the U.S. due to different Controlled Foreigner Corporation rules.

**Our stock price may be volatile so you may not be able to resell your shares of our common stock at or above the price you paid for them.**

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



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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.

**Table of Contents****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The table below sets forth the information with respect to repurchases of our common stock during the three months ended June 30, 2013.

| Period                                     | (a) Total<br>Number of<br>Shares<br>Purchased | (b) Average Price<br>Paid per<br>Share | (c) Total Number<br>of Shares<br>Purchased as Part<br>of Publicly<br>Announced<br>Plans<br>or Programs | (d) Maximum<br>Number of Shares<br>that May Yet<br>Be<br>Purchased<br>Under<br>the Plans or<br>Programs (1) |
|--|---|--|--|---|
| Month #1 (April 1, 2013 to April 30, 2013) |   |  |  | 355,192   |
| Month #2 (May 1, 2013 to May 31, 2013)     | 100,580                                       | \$ 15.73                               | 100,580  | 254,612   |
| Month #3 (June 1, 2013 to June 30, 2013)   | 75,198  | \$ 16.84                               | 75,198   | 179,414   |
| TOTAL                                      | 175,778                                       | \$ 16.21                               | 175,778  | 179,414(2)  |

(1) In January 2012, our Board of Directors reaffirmed its authorization for the repurchase of 1,966,700 shares of our common stock all pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, as amended. In July 2013, our Board of Directors authorized the repurchase of an additional 2,000,000 shares of our common stock pursuant to Rule 10b-18 of the Exchange Act.

(2) The number represents the number of shares of our common stock that remain available for the repurchase pursuant to our share repurchase program.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**Item 4. MINE SAFETY DISCLOSURES**

Not applicable.

**Item 5. OTHER INFORMATION**

Not applicable.

**Item 6. EXHIBITS**

| Exhibit<br>No. | Description   |
|----------------|---|
| 31.1           | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer                 |
| 31.2           | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer                 |
| 32             | Section 1350 Certification of Chief Executive Officer and Chief Financial Officer |
| 101.INS        | XBRL Instance Document  |
| 101.SCH        | XBRL Taxonomy Extension Schema Document   |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document                             |

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|         |  |
|---------|--|
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document       |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CEVA, INC.

Date: August 9, 2013

By: /s/ GIDEON WERTHEIZER  
Gideon Wertheizer

Chief Executive Officer

(principal executive officer)

Date: August 9, 2013

By: /s/ YANIV ARIELI  
Yaniv Arieli

Chief Financial Officer

(principal financial officer and principal accounting officer)