

# FINAL TRANSCRIPT

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**ARM.L - Q2 2009 ARM Holdings plc Earnings Presentation**

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## PRESENTATION

**Warren East** - *ARM Holdings plc - CEO*

Okay. Good morning, everybody. Thank you very much for coming along to our Q2 and half year set of results. In the usual way, I'm going to give a short update on the business and what's been going on within the operation, and Tim will add some color to our numbers.

So, highlights to begin with. I think that what we've been talking about this morning is that we're very pleased with this set of -- sorry, I was hearing something. Okay. I was -- we were very pleased with this set of numbers, demonstrating really the resilience of ARM's business model and ARM's position in the market. Semiconductor industry in revenue terms down about 30% for the first half of the year. We're feeling pretty good with the first half of 2009 for ARM, with our revenue down just 14% and the margin holding up well.

The picture that we've got on the slide here, you should recognize if you've been to a few of these and been to our Analyst Day. We're trying to put some consistency into the pictures we're using. The business, all about building the platform of licenses; two thirds of our business coming from our Processor division and the proportion shown there. But the three areas where we're growing our business through growth in non-mobile, increasing the value of ARM technology in the mobile sector, and extending the range of technologies that we're outsourcing.



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And so, we continued to build the licensing platform in the second quarter; another 17 licenses sold. That's 34 licenses in the first half of the year. In a normal year, we will sell 60 to 70 microprocessor licenses, if you look at that over the last few years. And so, quite pleased with the numbers that we've got there. And particularly pleased to see some Cortex licensing and momentum from Mali as well, the graphics processor; talk a bit more about that in a moment.

Looking at the other growth objectives. Gaining share in all our target markets really; a metric we've been chasing for some time of two ARMs per handset is there. Growth outside of the mobile space with new products announced from our semiconductor partners, targeting non-mobile applications. I'm going to talk about the physical IP activity and our 32 nanometer program, where we've reached a significant milestone this quarter. Back at ARM, we've been exercising in this difficult year good, tight, financial discipline, and that is translating into profits holding up well, to the extent that we're reiterating our guidance and showing some confidence in the medium term.

So going on now to a little bit more detail in the different parts of the business. Processor Licensing is holding up; our revenue is down just 2% versus last year. I mentioned 17 processor licenses in total, which puts us in a good position for the year as a whole. When you look within that Processor Licensing activity, I'm very pleased to see a good mix here; eight Cortex licenses, some licensees for the microcontrollers as well, M0.

We're seeing an application spread, things like digital TV as well as mobile computing. And included in those Cortex licenses are two licenses for the lead partner licenses for our next generation Cortex products as well. So there's a bit of an indication of the future coming down here too.

Non-mobile continued to be a strong driver for licensing, as well as mobile. The pie chart at the bottom of the screen is showing the proportions there of non-mobile versus mobile or both. Microcontrollers; got another slide or two on microcontrollers, because that continues to be a key growth area for us. And we've seen both licensing activity and product launch activity in the microcontroller space.

Within mobile, the opportunity is increasing. And you can see the progress to two microprocessors per phone. But we'll talk about some other things going on within the mobile space as well. So that's Licensing.

If I switch to royalties; the story here is one of continued outperformance. The chart on the left of the slide there shows that this is not new. Historically, ARM outperforms the semiconductor industry because we are continuing to grow market share. And over the last several years, we've done that consistently. And that's what's led to the consistent outperformance, when you work out the CAGRs at the bottom of the slide there.

And that type of performance, vis-a-vis the industry, has continued throughout the first half of 2009. Looking at the right-hand side of the slide, if I look specifically at the second quarter, obviously volumes down, reflecting what's been going on in the semiconductor industry, where we have seen a lot of inventory destocking. Don't forget, these royalties refer to industry shipments in calendar Q1. And it seems like a very long time ago Q1 now, but that's what's driven these royalty numbers. We -- remember, there was continued inventory destocking during the quarter.

So industry down; actually, for both and non-mobile, ARM volumes were also down approximately 20%. And that's indicative of some increased market share, some outperformance of the industry. Actually pushing into the detail of these numbers is quite challenging, given the amount of inventory destocking that was going on and the whereabouts of that inventory in the chain. So I don't think we should dwell too much on the detail there. The message is one of continued outperformance.

I think the other important thing to note is that, in overall terms, the volume there is still ahead of the volume in, say, Q3 of 2007. So we've gone back a little bit, but not really very far.



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And the other important thing to note is that we can already see the semiconductor companies reporting a good improvement for Q2, forecasting sequential improvement as we go into Q3. And that, of course, bodes well for our royalties in Q3 and Q4 this year.

If I look within the types of products shipping, then ARM11, strong growth in ARM11, but it's still only 6% of the total. And it's good to see some Cortex products shipping as well in some new phones, like the Palm Pre. Now that's single digit millions of units at the moment, but it's good to see the Cortex products starting to ship in appreciable volume.

Looking behind those royalty numbers, I'm just going to talk a little bit about non-mobile and then mobile. Again, trying to have some consistency of the pictures, this is the slide that we first showed at our Analyst Day in 2007, where we have microcontroller oriented companies, some who, in the red box, don't use ARM, some in the orange box who do use ARM but not in microcontrollers, and then in the green box, those who use ARM and use ARM in microcontrollers.

And so, the snapshot of the first one we put up from Analyst Day 2007. Then a few weeks ago, at our Analyst Day in May this year, the picture had changed to many more companies within the green box. And in fact, with the launch of Cortex-M0, which was the Swift product when I stood here in February and talked about some new products, the M0 extends our market opportunity in microcontrollers.

So if I look at what's gone on, specifically within this quarter, then not a huge change since the Analyst Day in the red box migrating to the green box. But actually, it's quite a lot of activity been going on within the green box. This is companies who already use ARM in microcontrollers.

And so, the list in the points down there on the right-hand side of the slide, we've got a whole host of companies announcing their Cortex-M3 based products, bringing those licenses that they took over the last few years, bringing them to market in conjunction with ARM's tools activity -- development tools activity. ST had a particularly great announcement on Cortex-M3. We've also seen NXP, who brought the first M0 product to working silicon, at the same time as announcing their M3 family of microcontrollers. We've had a bit of additional Cortex-M0 licensing; you can see there.

Actually, people -- all of the microcontrollers, well, most of the microcontrollers that are shipping today on ARM are actually ARM7 and ARM9 based microcontrollers. So there's still some activity there on new ARM7 and ARM9 based microcontrollers. And you can see that with Toshiba and Maxim.

And then there was also an announcement which we enjoyed from TI during the quarter, where they acquired the Luminary business, and put an extensive line card of ARM based microcontrollers from Luminary together with Texas Instruments, this sales and distribution machine. And we think the combination of those is a good boost for the ARM microcontroller world. So expect some more partner announcements over the next few months as well in microcontrollers.

Hidden away on the bottom of the slide here, because this is actually a slide on non-mobile and we didn't want to put another slide in the pack, there are plenty of other announcements detailed in the earnings release, about other ARM based products outside of mobile, but non-microcontrollers in enterprise and consumer electronic markets.

So if I switch now to mobile. The story here in mobile is about growing the amount of ARM technology per device, therefore increasing the amount of royalty that ARM earns when a consumer goes into a shop and buys a phone. And the message here for some time has been that smartphones have an increased number of ARM chips, higher value ARM chips and more ARM chips. And therefore that's good for our royalty.

And then, we've had a metric going for some time, where we've been looking at the total number of phones shipped and the total number of ARMs chipped -- ARMs that go into the phones and dividing one by the other to come up with an average. And that average has been steadily increasing from when we started it a few years ago at 1.2 cores. It's now reached two cores per phone for the first time. And that's driven by multiple ARMs in different pieces of functionality in the phone.



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The high end of the smartphone space, you're seeing, as I mentioned, Cortex-A8 starting to appear. Things like the Palm Pre, if you've played with it, a fantastic piece of kit. In fact, all of those phones there we have played with, and you can do some incredible things with the Cortex-A8. So these phones that we've been talking about on PowerPoint for some years, it's very good for us to see them actually in real products. And it's good to see those real products starting to generate royalty.

One of the things you should note is that generally, and we say this in one-on-one meetings with the investment community, generally, there's a little bit more royalty for the more sophisticated phones -- sorry, more sophisticated ARM microprocessor cores. And, of course, those microprocessor cores are going into more expensive application processors, which helps to increase the royalty again. So this is very, very small volume at the moment, single digit millions of units Cortex-A8, but it's good to see it coming through into some royalty.

Now there's been lots of press in the mobile sector over the last quarter, in fact, over the whole of this year, about ARM's opportunity in mobile computing. And we wanted to take the opportunity here of putting a bit of context around that.

So the picture shows a typical mobile computer, a small, netbook type computer. And you can see there are a number of potential ARM sockets there, showing pictorially at the top, and in tabular form at the bottom, on the left-hand side of the slide.

Using the measure that we've used before of one unit of royalty for the amount of royalty that we earn on a simple baseband modem, then you can see a similar amount of royalty for, say, the processor in the camera, the touch screen, the Bluetooth or the WiFi. Similarly in storage. 3G baseband modem probably a bit more sophisticated and, therefore, a more sophisticated chip and a more expensive device. That's typically going to be about three units of royalty. And then the applications processor that sits in one of these would be a high-end applications processor that would generate more royalty.

So if you look at the proportion of ARM market share there, you can conclude that in a typical product where we're not present in the applications processor, then ARM is going to earn between three and four units of royalty, when one of these is sold. And the opportunity that we're talking about is to put ARM into the applications processor, which will roughly double the amount of royalty that we earn when a consumer goes and buys one of these products.

So that's the context of ARM's opportunity in mobile computing. And there's various market forecasts for exactly whether this netbook space is really going to take off. And the answer, from our point of view, is that we can look at the forecasts the same as you can. We've looked at several forecasts there and concluded that a reasonable spread of those forecasts would take us to getting on for 200 million units in 2013, off a relatively small base of less than 20 million units last year.

And so, I think the scale of the opportunity here is to double ARM's royalty by getting designed into the application processor socket, and to double that royalty into a growing sector of the computing market, because mobile computing does have some rapid growth potential.

Now mobile computing is all about the Internet really. And at the Analyst Day we had here a few weeks ago, we had Ian Drew talking about what made for a good Internet experience, and the fact that we needed several pieces of software. You need the operating system, you need an optimized browser, and you need a range of plug-in software. And in fact, we had a slide that hinted at that exactly 12 months ago, when I stood here. And at the end of Q2 2008, we'd started on this activity, developing the eco system. And we had some supporting announcements from Adobe, Microsoft, Mozilla and Co, and the logos shown there.

So that was 12 months ago. Quite a bit has happened over the last 12 months, and even through the last quarter, and it's really been a story of PowerPoint turning into reality. And so the logos are now populated with what's there, and what's coming now; huge difference from 12 months ago. And we're very excited by the latest announcement, a few weeks ago, when Google talked about their Chrome -- extending their Chrome browser into the Chrome operating system, and making that available to support the ARM architecture from day one.



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So there's been a lot of activity from ARM, and from the ARM partners, developing the ecosystem to make the Internet experience a good one, and to deliver the reality of the Internet experience on the ARM architecture.

Now that's all been stimulated by mobile computers and netbooks and that sort of thing. But we would also highlight the fact that it's not really just about that. It's about a whole range of products where screens vary from very small to very large. And it's about delivering a seamless, consistent Internet experience across this huge range of platforms.

And we believe that this huge range of Internet connected platforms mean there's an opportunity for about 2.5 billion things in 2013 that are connected to the Internet. And that's any screen size for people to use in all sorts of different circumstances. There's a whole range of products, different companies are competing in different ways to get share in this space, so they're inventing online stores and creating online identities. They're delivering productivity to the user, so the user can improve their Internet experience, and delivering productivity to companies, where this is getting actually used within the enterprise space.

So we see a world that's much bigger than just mobile computing. This is about making the Internet a reality and making it part of everybody's lives. And we see, within that, a huge opportunity for connected consumer electronic devices, and therefore a huge opportunity being driven for volumes of ARM based devices. And that's why we've put a lot of attention into developing our Internet ecosystem.

So that was a little bit of background on, first of all, non-mobile, and then mobile, growth there.

The third area of growth is extending our IP outsourcing into other technologies, fleshing out our product portfolio. One of the areas that we've been working on there is our graphics processor line. And it's been a good first half to the year in our graphics processor line where we've sold as many licenses in the first half of this year as we sold throughout last year.

And we've been selling those licenses to a range of different companies for not just smartphone applications. And that licensing's been happening in a difficult period for the industry, which we find particularly encouraging. On the right-hand side of the slide, you can see that shipments of these products is starting to grow as well. Not only do we enjoy smartphone shipments from our historic imagination based graphics activity, but through our new Mali graphics product line we're starting to see some volumes shipped now. Fairly significant volumes in Q2 adding to the base there, and these are some of the products that Mali is shipping in.

The other area where we're extending our technology portfolio of course, for outsourcing, is Physical IP. A quick update on our Physical IP division. License revenue in the quarter behaved fairly well, up 5% sequentially. We had a handful of deals and, in particular, a new platform at 90 nanometers. The licensing was across really a broad range of our Physical IP.

Royalties; underlying royalties were down year-on-year, obviously, but they were down year-on-year in a foundry sector which was down a lot more on a year-on-year basis. And this is indicative of more widespread use of ARM's Physical IP within the semiconductor world. And the good news is that foundry revenues, having been hit very hard in Q4 and in Q1, therefore driving these royalties, we're seeing a substantial uptick. The graph on the top there shows the foundry revenues reported in -- or forecast for Q2, being reported as we speak. And that is the opportunity for ARM's Physical IP as we go forward into the second part of the year.

So we're looking forward to improvements in our Physical IP royalties in the second part of the year.

Now some of the licensing activity, as we look forward, will be driven by the advanced nodes. And we stood here a little while ago and talked about our 32 nanometer program, and I think the report on that for this quarter is that it's on track. Here's a chart of the activity throughout the whole of this project up to date. And on the top of the slide you can see what we're doing from a technology point of view, and on the bottom of the slide, what we're doing commercially.



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And engineering work has progressed. By the time we got to Barcelona this year, we had a wafer with our first 32 nanometer ARM microprocessor. We've been putting that microprocessor through its paces over Q2, so it's working well, and it's proved an excellent vehicle for testing our 32 nanometer technology.

We're now optimizing the next generation of Cortex processor with this 32 nanometer technology that we've been developing in our Physical IP. And we hope to have some pretty good results in terms of enhanced performance and enhanced power consumption, that are going to flow from that. In fact at our ARM partner meeting, happening in three weeks' time, we'll be sharing some of the results of that on a non-disclosure basis with the ARM semiconductor partners.

Now this time last year, switching to the bottom of the slide, this time last year we were in heavy negotiation with the common platform companies on licensing the 32 nanometer product. We had an announcement at the end of September when we licensed it to these companies, and we've been working with them through the second half of the project as lead partners. We took on an SOI variant, reported in the last quarter, and the milestone that we achieved this quarter was actually delivering some fully functional 32 nanometer physical IP to those players. And therefore being able to put a mark on the wall and way it's our first revenue recognition from this 32 nanometer project.

Not really moving the dial in terms of licensing revenue at the moment, but a very important milestone in terms of reaching delivery, on target, on time, and that bodes well for the future.

So, I just talked about Physical IP. Just to summarize the areas. Talked about Physical IP, the highlights there, we've got a 32 nanometer Cortex processor, and we're starting to recognize 32 nanometer revenue.

Continuing on the theme of extending the outsourcing in graphics; we're now shipping Mali graphics products; 50 million units shipped to date. More licensing activity for Mali during this quarter. As much licensing in the first half as in the whole of last year.

Talking about growth within the mobile sector, and without the mobile sector, then we've had growth of market share in both areas. Key milestones in mobile being launch of new smartphones incorporating Cortex-A8, and an exciting announcement from Google about their operating system, bodes well for mobile computing.

And outside of the mobile space, a whole host of new ARM products announced for microcontrollers, and actually a host of new ARM products announced for other non-mobile applications.

So we can see that, during this very difficult time for the industry, up to what we see now as really the low point, we've had fairly good market share gains during that period. The industry itself has been through a difficult time with destocking. Right now we can see destocking has come to an end, and that's why we're looking forward to a better second half.

And with that, I'll hand over to Tim.

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#### **Tim Score** - ARM Holdings plc - CFO

Thanks Warren. The usual quarterly adjustment. The good news is that today I've only got four slides. I'm going to use one to cover the Q2 and give a little bit of color on some of the numbers that have probably grabbed some attention this morning. Hopefully give a bit of background on that. A couple of slides just reminding us of the longer-term royalty opportunity, and what that means for longer-term prospects, and then look at summary and outlook. And then we'll move to questions about netbooks and other things.



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So, Warren's talked about the overall revenue performance. I think, on a dollar basis, you've seen that we were just about in line with consensus. Most revenue streams pretty much on; PIPD a little bit higher. The catch-up royalty was higher, at \$2.6 million than the more typical run rate of about \$1 million.

And the Development System revenue, as indicated last quarter, was going to be lower on a sequential basis. It's a little bit lower than consensus ended up being. I think the way to look at that when you're doing your models, is to think about Development Systems as having an underlying revenue of round about \$10 million to \$11 million. Then from time to time, but not every quarter, you're going to see some larger deals signed that may push it up \$2 million, \$3 million, \$4 million. So I think that's the way to think about Development Systems as you model that.

In terms of FX, I apologize that we have to spend a little bit of time on this, but the ARM numbers are obviously sensitive to FX, both on the top line and down further. As expected, and similar to Q1, the effective revenue rate of \$1.63 was, as we indicated it would be, six or seven points higher than the actual average, which was about \$1.56. So yes, \$1.63 was about what we expected. Consensus didn't quite get there, but it was relatively close.

And what we did say for the second half, is that the dynamic that we've seen both in Q1 and Q2, of our effective revenue rate being higher than the actual average, that kind of disappears for the second half, and will be much less of an effect. The effect was caused in the first half because of some revenue being recognized out of backlog -- that was booked into backlog, when the dollar was a lot weaker. And that's what drove this rate change.

But I think we can probably revert now to using the same FX rate for revenue and costs that had served us all fairly well up until the last couple of quarters. So, you can say \$1.63, no surprise. Clearly today we're sitting at around \$1.65, and therefore all other things being equal, if that's sustained during the second half, that would be about the average both on the revenue and on the cost line for ARM in the second half. But of course, who knows where it's going to go?

As Warren says, profitability has held up reasonably well, and we've been saying all year our underlying costs are flat. Our headcount is marginally down on the start of the year. We've had a pay freeze in place; most of our costs are people costs. And what causes the quarterly volatility in our OpEx of course is, one, the translation rate that you have to apply to our US dollar denominated costs, which are broadly half of our costs. And the impact of marking to market our forward contracts and other instruments that we use for our progressive hedging policy.

In this particular quarter, in Q2, the effective rate for translation was in the mid \$1.50s. As I said, that was the actual average rate for revenue, and therefore not surprising that the cost rate was broadly in the mid \$1.50s. That compares to something in the early to mid \$1.40s in Q1, so obviously we got a benefit on a translation basis.

And the more important thing this time is there is a net benefit in these numbers of broadly about GBP3 million, which comes from having a number of our forward contracts being in the money, as at the end of Q2. If you think about what the dollar's done over the last couple of quarters; it spent a lot of time in the late \$1.30s and early \$1.40s in Q1. We took out a number of forward contracts at that level, which are clearly in the money at the end of Q2, and therefore we benefitted.

Now, as I say, underlying costs are broadly flat, and this is why we're guiding Q3 at GBP45 million to GBP47 million. I think if the dollar stays where it is today, around \$1.65, you could expect our sterling costs in Q3 to be at the lower end of that range. If the dollar strengthened again, it might be up towards the upper end of that range. So, numbers that I see in the market for Q3 around GBP45 million, GBP46 million, look to be fairly sensible for our underlying OpEx.

Quick note on tax. For those who get that far down the P&L to look at the tax line, you'll note a rather strange impact for IFRS tax in the second quarter, of a nil effective rate. And what I would advise you to do is have a look at note 5.24 of the earnings release, which is our columnar presentation of the normalized numbers on the far left. And then moving across on a columnar basis to include share comp, amortization etc. And what you'll see is a normalized tax rate that you would broadly expect, in the mid 20%, giving rise to a GBP4 million tax charge. And then you will see a deferred tax asset against share-based



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compensation, of GBP2.5 million, and you'll see the normal tax deduction on the amortization of GBP1.5 million, which also adds to GBP4 million and gives you a nil net effect.

Now unfortunately, as we said, when we transition from US GAAP to IFRS, tax is the one area in IFRS that does drive more quarterly volatility in tax than US GAAP did because the treatment of share-based compensation is different and more dynamic, if you like. So I would focus your thinking about ARM's tax rate on the normalized numbers, and not spend too many brain cycles trying to forecast the IFRS tax rate on a quarterly basis, because it's quite challenging. And it will be affected by things like the share price on the last day of the quarter, which drives the deferred tax calculations on share-based comp. So, it's a difficult one; inherent volatility, but that's what it is.

On a cash basis, we are pleased that we're strong net cash generators through what I think most people expect to be the low point of the cycle. We end the year -- sorry, we end the half just under GBP90 million. I think in a sense, our headline cash generation in the first half is somewhat suppressed by the fact that we had actually our forward contracts out of the money at the end of the year.

And some of you who looked at the numbers would have noted quite a big fair value charge that we had to take at the end of the year. And as those contracts have crystallized through the first half, that's actually suppressed our net cash flow. And again, because those are now through, I would expect a pretty meaningful uptick in our net cash generation in Q3, Q4, partly through improved trading that Warren's been talking about, but also partly because we now don't have a fair value liability in the balance sheet. That's worked its way through in the first half.

And I think that the last thing to say, Warren emphasized it, I think in terms of the Board's view of the medium, long term of this business, absolutely no change. We're suggesting a 10% -- or announcing a 10% increase in our interim dividend. We'll obviously look at the final dividend at the end of the year and work out where we go. I think the general policy of our dividend tracking our earnings, or taking into account our earnings, remains. And even though this is likely to be a down year for earnings for most companies, we still see the medium, long-term prospects strong enough to support that progressive dividend.

And quickly, these are a couple of slides that I showed when I went through the investment case at the Analyst Day. And it's really just to remind you that still today, 94% of our royalties that we're earning are coming from ARM7 and ARM9. We've signed 140 licenses for ARM11 and Cortex in aggregate. ARM11 is starting to move the dial at 6%, Cortex is now starting to come through, and Warren showed some of the products into which it's being designed.

So even though you see that sort of short-term first half drop, which looks a bit alarming, normal service will be resumed relatively soon on the royalty growth. But I think the key point here is, you've got 220 licenses out there in the market of new ARM technology that are not really generating much royalty at this point, but will be soon.

And what that means is that that green bar at the bottom, which you can see over a multi-year view, is gradually edging up, although a little bit suppressed this half. That is going to resume its upward journey, and gradually royalties will increase as a percentage of the whole, which is probably the single key driver that takes these margins up through the 30%. And, as I've said a couple of times now at Analyst Days, north of 40% on a sustainable basis in the medium term. And it's that royalty number that's going to be moving that.

So, just to wrap up then before we move to questions. We've talked for a number of quarters now about our licensing potentially being impacted by very negative sentiment in the market. I think in the context of that, Licensing has held up pretty well through the first half of 2009. We have a flat backlog at the half year.

The opportunity pipeline for the second half, actually looks pretty promising. And it's a wide range of more mature products and the newer stuff, including some of the leading edge physical IP technology that Warren was talking about just now. Some very interesting opportunities in the pipeline for that technology in the second half.



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And although it's been quite hard to see trends in the PD royalty numbers in the first half, because of destocking, restocking, alignment with end demand. Everything we see, indicates to us that our market share gains are going to continue into the second half and beyond.

We're not, of course, standing here trying to call the end of the recession or the timing of the recovery. But what we are saying is, that when you look at ARM's numbers for 2009, partly because we're one quarter in arrears with royalties, we think we're pretty set fair. As Warren said, we know Q2 is well up for the industry. Most people are pointing to Q3 being well up, and that's probably on an increasing trend in terms of people's guidance. And I think the improved sentiment that's around in the industry, even though people aren't yet declaring victory, it isn't going to do any harm to a conversion of our licensing pipeline into deals in the second half.

So six months in, we're reiterating the full year guidance, which is for dollar revenues at least in line with current market expectations. Those -- although the words have been the same now for the third consecutive quarter, of course, the current market expectations have gradually been increasing, actually through this year. When we first said that they were in the mid [\$450 million]; we're now pretty much around [\$470 million], and we are repeating it. We are six months further down the line; we can see the royalties improving. So we're in a sense, we're repeating it with more confidence. But we're not here, as I say, declaring victory. But we have a pretty clear view of the second half.

So with that I'll pass to questions.

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## QUESTIONS AND ANSWERS

### Unidentified Audience Member

Thank you, right. I've got a couple of questions. The first is just having your thoughts on PIPD. If I look at the segmental profitability for the first half, you're sitting on basically GBP160 million of costs on PIPD for about GBP80 million annualized revenues. So it looks like your revenues need to almost triple to cover your cost. And I was wondering if you have you done your exercise to find out at which node do you think you will see those revenues since we are obviously, early in the deployment of PIPD technology and foundries and IDMs? Since it looks like a very far away event, but perhaps you've got your own thoughts on that?

And the second point is in terms of cash flow in the first half, you've got an outflow of about GBP20 million related to FX contracts. I'm sorry I don't remember the number in the first quarter, but if you could just indicate what was the impact in Q1 and Q2 in terms of P&L provisions?

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### Tim Score - ARM Holdings plc - CFO

P&L provisions in terms of --?

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### Unidentified Audience Member

So FX contracts or the impact on the P&L of FX?

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### Warren East - ARM Holdings plc - CEO

Yes. You do the FX, I'll do the PIPD.

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**Tim Score** - ARM Holdings plc - CFO

Yes, the impact on cash flow of crystallized FX contracts has been somewhere in the GBP10 million, GBP11 million, okay? And that's probably evenly spread over the two quarters. So I think if we hadn't had any hedging policy and we hadn't had any currency volatility and you could have expected to see in our net cash generation, more in the mid to upper teens than in the GBP11 million to GBP12 million. And what's happened is, if you look at the balance sheet at the end of the period, you can see that the fair value is now a very small number. And we're going to be returning to a world where our OpEx volatility for currency is plus or minus GBP1 million on a quarterly basis, not plus or minus GBP3 million.

**Warren East** - ARM Holdings plc - CEO

Okay switching to the PIPD question. I think the short answer is, right now, we can see PIPD's profitability switching round over the next few years, where a few is two to three years. And that's because of royalties in two parts. The underlying royalties, as you can see from the presentation in the older technologies actually gaining -- continuing to gain market share from all the licensing, which has been happening, and you can see is coming through in market share growth. But also as the newer technologies, 45 nanometers and better, start to ship.

I stress the milestone on 32 nanometer delivery because this is advanced technology that is now in a form that can be licensed. And so we do expect to see an improvement in the PIPD numbers from licensing as well. So we can see an upward trend in PIPD revenue.

Also we are continuing with programs of operational improvement in that division to help drive the cost down. And over the next two to three years we can see revenue going up and cost coming down together in that division to improve the profitability. (inaudible).

**Tim Score** - ARM Holdings plc - CFO

Just to say, I think when you look at the segmental analysis and think about how PIPD changes it, I think you need to bear in mind that the marginal impact of improved revenue on PIPD is much more significant than this might suggest. Because this segmental analysis takes a., all the amortization of intangible asset into here, it takes PIPD share obviously the share-based compensation.

And it also takes an allocation on a sensible basis applied across the Group of all of the Group overhead and all of the central functions, and all this sort of thing. So the marginal impact on PIPD of improved revenue is -- impact on the Group results is much more significant than this might imply.

**Unidentified Audience Member**

So how much are the normalized OpEx then associated with PIPD?

**Tim Score** - ARM Holdings plc - CFO

Pardon?

**Unidentified Audience Member**

What are the normalized OpEx associated with PIPD?

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**Tim Score** - *ARM Holdings plc - CFO*

I think if you think very broadly around a third.

**Unidentified Audience Member**

A third?

**Tim Score** - *ARM Holdings plc - CFO*

Yes.

**Unidentified Audience Member**

Okay thanks.

**Robert Owens** - *Cazenove - Analyst*

Morning, Robert Owens from Cazenove. A couple of questions, first on Licensing. I might have missed it in the release but, can you tell us the proportion of Licensing revenue that came from the backlog in Q2?

And then on Mali; of the 22 licensees to date, how many of those were actually standalone Mali licenses? Thanks.

**Tim Score** - *ARM Holdings plc - CFO*

Do you want to do the Mali?

**Warren East** - *ARM Holdings plc - CEO*

Yes. On the Mali, I can't tell you the number off the top of my head exactly. But in the main they're standalone licenses but to ARM partners. So we do have at least two I think, Mali designs where the Mali is sat alongside a processor that isn't ARM. But in the main we're licensing it to ARM partners. Exactly how many deals are done concurrently, I'm afraid I can't tell you right now.

**Tim Score** - *ARM Holdings plc - CFO*

Yes, I must admit I don't have to hand the -- Ian do you have the proportion of revenue from backlog to hand?

**Ian Thornton** - *ARM Holdings plc - Director of IR*

I don't, no.

**Tim Score** - *ARM Holdings plc - CFO*

No okay, I'll send -- I'll get that one around to you sales side guys.

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**Robert Owens** - *Cazenove - Analyst*

Thank you.

**Warren East** - *ARM Holdings plc - CEO*

Nick.

**Nicolas Gaudois** - *UBS - Analyst*

Yes hi, Nicolas Gaudois, UBS. Could you expand a little bit on the licensing pipeline for 32/28 nanometer for PIPD, because this seems to suggest the technology basically is deliverable? We've got one large foundry which has trouble with 40 nanometer; we've got another foundry being set up as a new JV. So it looks to me like -- as if the body language is warming up there?

And secondly if you could give us, maybe Tim, a bit of initial view on OpEx into Q4 versus what you set up for Q3, and how you're thinking about costs into next year so both absolute level? But also how should we think about gross margins versus OpEx now that some costs have transitioned from COGS to R&D for PIPD? Thank you.

**Warren East** - *ARM Holdings plc - CEO*

Okay color on the licensing pipeline for 32 nanometer technology; we put 32/28 up there on the slide. We're undertaking this as one project, but what's actually licensed and what's actually delivered at the moment is 32 nanometer common platform technology. All the players in that camp are looking towards eventually moving to 28 nanometer rather than 32, and there is an additional opportunity for licensing the 28 nanometer products into that world. And when we do license the products into that world, then we would expect to pick up some of the benefit from the engineering project that's already been done because we won't be going completely back to a blank sheet of paper.

In terms of the players then, there are the foundries who are there, there are the foundries that are going to come into that camp that are in discussion with the people who are licensing that technology. And exactly when they move into that camp and when they license that technology is a matter for those companies, and not for us to comment on. But as and when it happens, then it opens up an opportunity for us to sell that technology.

And then that's one dimension. The other dimension is the products within the particular technology, 28 or 32, that we're actually licensing. And when I talk about standard cells or IOs, there's a kit of standard cells, there's a kit of IOs. And some of these are products that we call enhanced IP, which are designs which are optimized for implementing our Cortex microprocessors, either to achieve low power or to achieve high performance, or some combination thereof. And the opportunity is to license that enhanced IP, both to the foundries themselves, but also to the potential customers of those foundries.

**Tim Score** - *ARM Holdings plc - CFO*

On the costs and margins going into the end of this year and into next, fundamentally there's no upward pressure on OpEx for Q4. As I said, the key components of that, which are headcount and employee related costs, are running flat. Whether in reality Q4 tweaks up a bit will depend on how we're seeing 2010 and if -- it's all about the pace of investment in people really. But I think at the moment assume that it may edge up a little bit, but not much.

Going into next year, clearly one thing we need to seriously consider is what we do about pay, having been through a year of a pay freeze. If the world is in a slightly sunnier place, I think that'll be a difficult and probably suboptimal challenge to try and pull off to keep it there for another year. I've got plenty of ARM colleagues in the back of the room gasping with horror at the

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notion. So there'll be a little bit of wage inflation, I suspect, coming into the business. But in regard to the pace of investment generally, I think it will be quite closely tied to how we see the prospects for the industry. So we will be pulling those levers as appropriate.

I think the margin profile that you see in today's results is probably a pretty good base for looking forward. And I think physical IP and the way our strategy within physical IP about spending more time building generic leading edge platforms, than customized business, I think moves our engineering classification more to the traditional ARM model of OpEx rather than cost of sales. And therefore I think the split you've seen in this quarter will probably be repeated.

So I do see this business consistently being over 90% on a gross margin basis. And, as the royalties grow faster than licensing over time, that provides a little bit of upward pressure on that. So I don't think this quarter's a one-off in terms of classification.

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**Sandeep Deshpande** - JP Morgan - Analyst

Hi, Sandeep Deshpande from JP Morgan. Just a quick question on the embedded space; clearly you've had a lot of wins with the Cortex-M3 and the M0. In terms of the volume that you're already seeing in your royalties, what percentage of that is already coming from this embedded space? That's one. Or do you expect that those volume -- that volume growth is somewhere out in the future?

Secondly, how are you seeing the ASPs of that royalty, is that -- is it substantially lower than where you've seen it with the mobile and your historic royalty levels, or historic royalty rate?

And then secondly moving on to PIPD, again a question I've asked before, but since you acquired this business, the level of revenues in PIPD royalty haven't really moved to a different level. When this business was acquired there was some conversation about, there were lots of customers who were not yet shipping. And we have not really seen that revenue actually break out of the range as such really. So at what particular point do you expect to see that -- ARM broke out of that range of royalty revenues quite early in its -- after you started licensing or rather once you got major customers. But at what point would we expect that on PIPD?

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**Warren East** - ARM Holdings plc - CEO

Let me answer the embedded one first. So I'm talking about embedded -- the microcontroller section really. It's 14% today of the overall royalty; that's the number for the latest quarter. Within that, then, it is almost exclusively ARM7s and ARM9s, ARM7, ARM9 based microcontrollers. There's been a lot of activity from a licensing point of view on M3 and some starting on M0, but as I said in the presentation, the whole Cortex volume at the moment is very, very small single digit millions of units. So we see all that licensing activity and product development as a good sign for the future, and it's off strong growth that has today delivered up to 14% of our royalties.

On the PIPD royalties --

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**Sandeep Deshpande** - JP Morgan - Analyst

Sorry on the ASPs.

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**Warren East** - ARM Holdings plc - CEO

Oh sorry on the ASPs, these microcontrollers, there is a range from under \$1 to the circa \$10. It really depends on how much other technology there is on the microcontroller. There are some really very sophisticated chips with big onboard peripherals

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as well as the microprocessor that is on there. But I think, we've always said that when microcontrollers are a significant north of 25% of our total royalties, then that is exercising downward pressure on the average.

And indeed you can see it in our royalty numbers. Today if you look at it over a quarterly basis, when we don't get the smartphone seasonality benefit there's downward pressure on the average royalty. When we do get the smartphone seasonality benefit, it drifts back up again.

Switching to PIPD, then the numbers are what the numbers are; you can see them in that range. I would contend that what we are seeing in these numbers, and indeed in the last quarter's numbers, the numbers driven off a sector that was really very sharply hit. And if you look back a few quarters to the second half of last year, then you saw us reporting royalties in the region of \$10 million a quarter, rather than in the region of \$5 million a quarter. When we bought the business it was about \$5 million a quarter and now it's about -- or it got to about \$10 million a quarter. So I would contend that, whilst not a major breakout, it's certainly not totally constrained; there has been a sign of significant progress.

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**Tim Score** - ARM Holdings plc - CFO

I think I may have made the same point when you asked the question last time. But we shouldn't forget that in 2008 PIPD royalties were up 26% at a time when the processor royalties were up 28%, and the overall industry was marginally down. So there is evidence of some quite good progress. And if you actually look at it foundry by foundry, node by node, we're still not benefiting from much royalty from the licenses we've signed post-acquisition. Starting obviously, but because of the three to four year lag, that's only really starting to move the dial now. Clearly we've gone through this artificially low period for the first half of this year.

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**Nick Hyslop** - RBC - Analyst

Nick Hyslop from RBC; I had a question on your cash balance. You're rather suggesting this is probably going to be the low point for the year, or hopefully. You're now up to GBP90 million. Do you think, with stronger cash flow in Q3 and Q4, you might restart the share buyback?

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**Tim Score** - ARM Holdings plc - CFO

No we would expect, all other things being equal, that on an underlying trading basis that cash balance will go up in the second half. The buyback remains in play, in position. The Board view over the last few quarters has been, uncertain trading environment, focus on getting the business through this period, focus on progressive dividend. The buyback is a tool that if we think it's appropriate to buy back shares we will do so. The current view is that it's inactive, maybe temporarily, maybe for a longer time, but certainly if we thought that it was within the interests of shareholders to buy back shares in ARM, we'd be doing it relative to all the other things we could do with our cash.

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**Nick Hyslop** - RBC - Analyst

You have mentioned GBP50 million as a sort of comfort level; you're well above that. And you're rather suggesting that Q3 and Q4 cash flow is going to be even more above that. So is it possible you're looking to buy things, or what are you going to do with that?

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**Tim Score** - ARM Holdings plc - CFO

Well just to put some context on the GBP50 million, as we readjusted our balance sheet shape, we guided in early '07 that we would move to GBP50 million by the end of '07. Now what's happened since the end of '07 is the world's become a very different

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place in terms of balance sheet structures, trading predictability, Board attitude to cash conservation etc. And so you've heard us talk, over the last 18 months probably, of being prepared to see that ride up.

Yes, I think there are opportunities in this environment potentially where we can do some sensible bolt-on acquisitions; we're looking at those sort of all the time. And if anything fits all of the criteria around strategy and culture and value, then we may well do it. And I think the Board again is kind of interested in looking at that versus buyback in the short term. But again we'll see; the buyback's still in play.

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**Nick Hyslop** - RBC - Analyst

Can I just have one follow up? Just on the backlog, I think you say in the statement that it's flat in Q2 on Q1. Is there any change in the maturity profile of the backlog as it currently stands?

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**Tim Score** - ARM Holdings plc - CFO

The maturity profile is in the slides that will be on the web; I think there's a small change. I think if you look at the proportion of the backlog that's over 12 months, it's gone from sort of 39% to 42% something like that. But no, I don't think any material change in the way you look at second half licensing revenue.

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**Nick Hyslop** - RBC - Analyst

Thank you.

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**Brett Simpson** - Arete Research - Analyst

Hi, it's Brett Simpson at Arete. A couple of questions for Warren. First up, this month the Chinese government took an architectural license with MIPS targeting or looking to support a [Nasa and] IC design houses in China. I wanted to get your perspective on that since a lot of the product areas are targeting is historical where you've done well in that region.

And secondly, I wanted to get your perspective on what Intel's been doing over the second quarter. They clearly -- they bought Wind River, where there's been a lot of ARM activity in the past; they have launched [Mobilien]. And I just wanted to get your sense for how you see Intel as a threat and whether they'll have any impact on the smartphone application processor space over the next two or three years?

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**Warren East** - ARM Holdings plc - CEO

Okay, start with the Chinese government; we saw that announcement. As it happens ARM has licensed cores to vehicles of the Chinese government over the years, and so no we see this as MIPS doing the same thing. MIPS is a smaller business than ARM, but it's a competitor. They're designed into a number of areas that we'd like to get designed into. They do an amount of licensing revenue every quarter, which is indicative of the fact that people are still designing in MIPS technologies. We see it as a fact of life, but we feel that we're actually quite well positioned in China, having already done quite a bit of that type of licensing.

Switching to

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**Brett Simpson** - Arete Research - Analyst

Warren, can I just add, would you be willing to do a similar deal with the Chinese government? Would it make sense, commercially, for ARM?

**Warren East** - ARM Holdings plc - CEO

Depending on the terms, it might make sense commercially for ARM. But as I say, we've already done a handful of deals with what I term vehicles of the Chinese government. And it's just a matter of which department you happen to work with. There's all sorts of government backed incubator activity in China, some of which is -- it tends to be regionally based, and we work with about half a dozen of those regionally-based outfits in China.

Wind River purchase and Mobilien and Intel; this is absolutely sensible sounding move from Intel as far as we could see. We wouldn't have a wish to buy Wind River ourselves. There's a lot of cost there that wouldn't make sense for ARM; it might make sense for Intel. Of course, Wind River would contend today that they'll continue to offer the same levels of support to ARM based designs as ever before, but I'm not too sure about that. And that's probably why, since the announcement, ARM has been inundated by a lot of people either wishing to switch their designs, or from different competing operating system companies who want to work with ARM to help switch customers from Wind River.

The Mobilien's activity's been well trailed for some time; the fact is, you need to have a good Linux solution to work in this netbook space. This might be enough of a hook for me to point out that the presentation that you've just seen is on a Linux based ARM machine, and we've been running that this morning.

You do need that sort of thing to make these mobile computers work. And there's a number of Linux camps out there. Mobilien is one of them, and it's part of Intel competing with ARM in the smartphone space. Whether that's actually going to help or not is another matter.

**Brett Simpson** - Arete Research - Analyst

Maybe just a quick follow-up with Tim on share-based compensation. Clearly, the number's up over 20% sequentially, some of that might have been share price driven. But can you (inaudible) the policy that you have for awarding stock base going forward? A lot of the chip makers and your licensees are talking about cutting overtime, what's your thinking internally here?

**Tim Score** - ARM Holdings plc - CFO

Sorry what was your last comment?

**Brett Simpson** - Arete Research - Analyst

A lot of your licensees, people like Broadcom etc., are talking about cutting that quite significantly going forward, what's your thinking?

**Tim Score** - ARM Holdings plc - CFO

Our general thinking on share-based compensation is unchanged, in that pretty much all of our 1,735 employees add value to the operation. It's a completely people-based business, and it's really structured around grades and it's structured around your ability within a grade. And there are very predetermined levels of stock compensation that employees get on an annual basis, and I would describe them as modest to very broad based.

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In terms of the Q2 versus Q1 there are a couple of things in there. The two factors, one is quite a considerably higher share price through the quarter than the previous one, and also our 2009 RSU grant to all of the employees, actually had a full quarter in the second quarter and only part of a quarter in the first quarter, when you're doing the weighting. So it gives it quite a sequential kick, but our underlying policy is unchanged.

We have absolutely no plans to reduce it as a proportion of the overall package, because we think it's still a valuable piece of motivating the troops and having them aligned with shareholders basically.

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**Brett Simpson** - *Arete Research - Analyst*

Thanks.

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**Andrew Gardiner** - *Barclays - Analyst*

Thank you, Andrew Gardiner from Barclays. I just had a general question on licensing activity. Earlier this year there was some discussion of potential licensees, or existing licensees, pushing back a little back in terms of signing new deals, given the environment that we find ourselves in. I'm just wondering whether you've seen any change in their attitudes towards that? And perhaps, also given that you've changed your disclosure slightly this quarter, whether there's any shift in terms of single use versus multi use and any additional color you can provide around that? Thank you.

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**Warren East** - *ARM Holdings plc - CEO*

Yes, I think at the beginning of the year, as I alluded in the presentation, we were very concerned that our customers would push out licensing in a difficult environment. And that remains the case; it can be done. But when we had our Analyst Day here a few weeks ago, we talked about different license models, we talked about term licensing and per use licensing. And we have seen evidence of people finding it harder to license our technology for economic reasons, and we've sold more term licenses and per use licenses perhaps than done in a different time. And that's absolutely consistent with what we said a few of weeks ago in May.

Within that, the big players have projects which are long-term projects and they're important for their competitiveness to carry on developing those road map products. Some of the smaller companies have had some very difficult times and a relatively small, in dollar terms, level of ongoing single and per use, single use and term licensing that we would normally enjoy from those smaller companies, has effectively dried up, if I look over the last six to nine months.

We might like to think there's some signs of that coming back, because they can only postpone it for so long or they'd lose competitiveness completely. So we've seen a little bit of that activity, but as you can see from the numbers, we still sold 34 licenses in the first half of the year, and that compares with between 60 and 70 licenses on a per annum basis for the last four or five years. So it's about where it should be.

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**Arun George** - *Noble Financial Group - Analyst*

Arun George from Noble. Warren, just a question on the [schematic] you keep putting out on ARM chips per phone which has increased to two. Looking ahead, I mean what's the reasonable, in your view, the reasonable upper limit to this number?

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**Warren East** - *ARM Holdings plc - CEO*

Well when it was 1.2 we said it would get to two one day, and we said it probably would go north of two and, at various times in the past, we've estimated about 2.2 cores. I think somewhere between two and three is a reasonable estimate. We also put

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on various slides, perhaps not in this pack but in some of the others you've seen, a breakdown of where the ARM processors go. It's typically a baseband modem chip, it's typically an applications processor chip and it's typically a third some kind of connectivity chip. And if all phones go that way then there'll be at least three, and so the number will be north of three.

But also there's a large volume of low-end phones that perhaps don't have the apps processor as well. And so I can see the number remaining somewhere south of three for the medium term of the next three or four years.

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**Arun George** - *Noble Financial Group - Analyst*

Thank you.

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**Warren East** - *ARM Holdings plc - CEO*

We are going to need to wrap up the general q-and-a --

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**Tim Score** - *ARM Holdings plc - CFO*

Can you give us some keynote finale Simon? Are you going to stick with your question? Good man.

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**Simon Schafer** - *Goldman Sachs - Analyst*

Some good news about Chrome OS this quarter, but Warren, any news surrounding portability of Windows, main OS?

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**Warren East** - *ARM Holdings plc - CEO*

Certainly no news that we'd be able to talk about. Consistent with all our other messaging on that, you do have to talk to Microsoft about that. I think the reality is that it is a difficult decision for Microsoft and it's a difficult activity for Microsoft to support two processor architectures. That's why I said this time -- last time we were here; that remains the case. But we are making progress in the Linux world, because the world's moving on, in spite of Microsoft, and is demonstrated by the presentation that we gave this morning.

Compatibility does exist for our ARM based machines, and that's what's important to the user. Whether at the end of the day it is from one company or another is less important, providing the functionality is actually delivered to the user.

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**Simon Schafer** - *Goldman Sachs - Analyst*

That's actually my second question. You gave some forecasts surrounding this somewhat new segment of netbooks or whatever you want to call them, and you gave some market growth forecasts. But do you have any sense as to what share is reasonable to assume, and that's part of the segment of the market for ARM based architectures as opposed to Intel, which obviously is coming from a different ecosystem via a slightly different route?

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**Warren East** - *ARM Holdings plc - CEO*

Yes, so Intel is effectively coming from 100% and we're coming from 0% in this space. When we were at Computex's a few weeks ago, we shared an internal target where we said we'd like to get approximately 20% of the netbooks shipped in 2010. That remains an internal target. Now some of internal targets we beat next season and some we don't, but that's what we're shooting for in 2010.

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**Simon Schafer** - *Goldman Sachs - Analyst*

Thanks a lot.

**Warren East** - *ARM Holdings plc - CEO*

I think that needs to be about it. Tim and I are here for any follow-up questions, but thank you all very much for coming.

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