

THOMSON REUTERS STREETEVENTS

PRELIMINARY TRANSCRIPT

ARM.L - Q1 2013 ARM Holdings plc Earnings Conference Call

EVENT DATE/TIME: APRIL 23, 2013 / 7:30AM GMT



APRIL 23, 2013 / 7:30AM, ARM.L - Q1 2013 ARM Holdings plc Earnings Conference Call

CORPORATE PARTICIPANTS

Ian Thornton *ARM Holdings plc - Head of IR*
John Buchanan *ARM Holdings plc - Chairman*
Warren East *ARM Holdings plc - CEO*
Simon Segars *ARM Holdings plc - President & CEO Designate*
Tim Score *ARM Holdings plc - CFO*

CONFERENCE CALL PARTICIPANTS

Gareth Jenkins *UBS - Analyst*
Didier Scemama *BofA Merrill Lynch - Analyst*
Sandeep Deshpande *JPMorgan - Analyst*
Andrew Gardiner *Barclays Capital - Analyst*
Francois Meunier *Morgan Stanley - Analyst*
Simon Schafer *Goldman Sachs Group Inc - Analyst*
Sumant Wahi *Redburn Partners LLP - Analyst*
Kai Korschelt *Deutsche Bank - Analyst*
Janardan Menon *Liberum Capital - Analyst*
Jerome Ramel *Exane BNP Paribas - Analyst*
Matt Ramsey *Canaccord - Analyst*
Sumant Wahi

PRESENTATION**Operator**

Thank you for standing by and welcome to the ARM Q1 results conference call. (Operator Instructions). I must advise you that this call is being recorded today, on Tuesday April 23, 2013. Let me hand the conference over to your first speaker today, Ian Thornton. Please go ahead, sir.

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

Thank you, Stella. Good morning, everyone. This is Ian Thornton, VP of Investor Relations at ARM. On today's Q1 results conference call we have John Buchanan, Chairman; Warren East, Chief Executive Officer; Tim Score, Chief Financial Officer; and Simon Segars, President and CEO Designate.

On today's call John, Warren, Simon and Tim will take us through the highlights and comments from the quarter's results and we'll open up the call to a Q&A session.

As a reminder, the presentation and release can be found on the ARM Investor Relations website at www.arm.com/ir.

Before I hand over to them, I just have to read out a few words with respect to this conference call and what we're about to discuss.



The contents of this conference call are being directed only to those of you who have professional experience in matters relating to investments and the information communicated on this call is being made available only to investment professionals. Any persons present on this call who does not have professional experience in matters relating to investments should not act or rely on the contents of this call.

The following conference call will contain forward-looking statements which are other than statements of historical fact. The Company's actual results for future periods may differ materially from these statements as they are based on current expectations and are subject to a number of risks and uncertainties.

And on that note, I'll hand over to John.

John Buchanan - *ARM Holdings plc - Chairman*

Thank you, Ian. Good morning and welcome, everybody. I'm John Buchanan, the Chairman of ARM. Thank you for joining our Q1 2013 results conference call.

As you will be aware, this is the last time that Warren will be reporting ARM's results as he'll be retiring as CEO at the end of June. Simon Segars, who joins us on the call today, will be taking over as CEO from July 1.

As you will hear, these are another strong set of quarterly results delivered by Warren and the team. More importantly, for a long-term business such as ours, these results are part of the foundation for ARM's future growth opportunity. As Warren's successor, Simon will play an important role in delivering on that opportunity.

In a moment I will hand over to Warren. He will run through the business highlights before handing over to Simon to say a few words. Tim will then provide some more detail on the numbers. As usual I expect we will cover much of the content in the Q&A.

Warren, over to you, please.

Warren East - *ARM Holdings plc - CEO*

Great. Thank you, John. Good morning, everybody. So after an excellent year for ARM in 2012 we're very pleased to be starting 2013 in this way this morning, where momentum has continued into the first quarter of 2013. There are some very healthy indicators that underpin the long-term growth opportunity for our business in these results.

As consumer electronic and embedded devices are increasingly becoming smarter and more connected, we're seeing our customers choosing ARM's technology for high performance and low power. And the demand is driving both our licensing and our royalty revenues. In the first quarter we saw particularly strong uptake of our most advanced ARM version 8 processor technology. Our customers are licensing this technology for use in smart mobile devices and computers.

The continued growth of the smartphone and tablet markets, along with the substantial demand for technology in other end markets, like microcontrollers and digital TVs, has helped increase our royalty revenues by 33% year on year this quarter. And that was significantly ahead of the overall semiconductor industry. Before we get too carried away it's worth noting that in that year-on-year growth we're comparing with a relatively low base. And that's because royalties in Q1 2012 were, you might recall, adversely impacted by a semiconductor inventory correction, and that was particularly biased towards the mobile industry. But that said, much of ARM's outperformance versus the semiconductor industry was based on our partners continuing to grow their market share.

The revenue momentum has enabled us to grow earnings by 58% in Q1 at the same time as continuing to invest in our R&D capability, hiring people, enhancing our ability to innovate and develop new products. As we look forward, we note that the semiconductor activity in the first quarter, which of course is the relevant shipment period for our Q2 royalties, was down by about 10%. And in this context we expect our revenues



for Q2 to be in line with current market expectations, although of course there's still some uncertainty in the wider macroeconomic environment. But nevertheless we expect Group dollar revenues for the full 2013 to be at least in line with current market expectations.

Now I'll just delve into a little more detail on the revenue drivers in different parts of the business, and we'll start with licensing. We signed 22 processor licenses in the quarter, and they were signed for a broad range of end applications, going from smartphones and mobile computing through to digital TVs and wearable technology. Half of the licenses signed were for Cortex-A technology. And this included seven licenses for our latest Cortex-A53 and A57 processors.

We continued to see traction in enterprise networking, signing a further v8 architecture license for use in this area. And some of the previous licenses that we've signed for high-end networking and servers are starting to bear fruit. And we saw significant design win momentum during Q1. That included Marvell announcing the deployment of some of the first commercially available ARM-based servers with Baidu, as well as LSI Logic announcing its [AXM5500] range of communications processors for high-performance, power-efficient networks.

We also signed seven licenses for Cortex-M and Cortex-R processors for use in a huge range of different applications, including the Internet of Things. And this included two more licensees for Cortex-M0+. That's our smallest, lowest-power processor. And for example, that has the potential to control and embed its sensor application for up to 10 years on a single watch battery.

This quarter Freescale announced a range of Cortex-M0+ based microcontrollers designed to help migrate consumer and industrial applications which currently use legacy 8 and 16-bit microcontrollers over to ARM.

Finally we signed three more Mali graphics licenses, two more POPs. POP physical IP is the IP that's been optimized to enhance the performance of both Cortex-A and Mali processors.

So now I'll switch to royalty. Our royalty revenues, don't forget, are reported one quarter in arrears. So royalty for Q1 was generated from chips sold in Q4. Processor royalty, the revenue was up 33% year on year compared with relevant industry revenues increasing by about 2%. That royalty was generated from 2.6b ARM processor-based chips reported during the quarter. In volume terms that's a 35% year-on-year increase. And that was driven by growth across all of ARM's end markets. Shipments of ARM-based storage chips were particularly pleasing as ARM-based Flash and storage-state drives more than eclipsed any decline that we've been seeing in PC hard disc drive controllers.

The growth of functionality in consumer devices like smartphones, tablets and digital TVs is also continuing to benefit us. During the quarter we saw a near trebling of Cortex-A class product shipments and only a five-fold increase in Mali processor shipments. That's year on year. Typically, of course, we receive a higher royalty percentage for Cortex-A class processors and an incremental royalty for chips containing Mali. Our average royalty per chip in Q1 was flat year on year as the growth in these higher-value but lower-volume application processors was balanced by strong growth in shipments of higher volume, lower-cost chips, like microcontrollers, smartcards, touchscreen controllers and wireless connectivity chips.

So now let's look about the operational and marketing highlights of the quarter. We've continued our investment in R&D. We're growing our engineering teams, working on advanced processors and graphics. We've added 69 people in the quarter and we expect that investment to continue in Q2.

Q1 is a very busy and exciting time for ARM and the companies within the ARM ecosystem, with big world events like consumer electronics, Mobile World Congress and Embedded World, which give our customers the opportunity to demonstrate their new technologies that will be going into products and services that we will all be enjoying as consumers in the years to come. And from having visited most of these shows, I came away with the following impressions.

We are truly in the post-PC era. The mobile computer is increasingly being used as the primary device in our digital lives.

Sensors. Sensors that are smart and connected are enabling new products, services and business models. Some of the most innovative technologies are solving old fundamental problems that are coming out of the -- those new innovative solutions for these old problems are coming out of the embedded smart sensor space.



And our technology is ready for servers and enterprise networking. And that's demonstrated by design wins by Marvell at Baidu, the recent HP announcement to use ARM-based chips from Calxeda and TI as well as the traditional x86 chips in their new server products.

And with that, I'll hand over to Simon to give his view of the quarter.

Simon Segars - *ARM Holdings plc - President & CEO Designate*

Thanks, Warren, and good morning, everyone. I'm not going to go into a lot more detail in the quarter since Warren has just covered that, but obviously that will be my role next time. However, when I look at this quarter and indeed the last few reporting periods it's the quality of the licensing that I find particularly encouraging. It's that installed base that underpins ARM's future royalty growth, the higher license revenue run rate that we've seen in recent quarters, together with the growth in the order backlog bodes very well for the trajectory of future royalty revenues.

The world's largest semiconductor companies continue to choose to license ARM's latest technology for use in their main product lines. In mobile computing markets they're licensing our latest processors. And many are planning to implement big, LITTLE implementations. And they're not just choosing to deploy processors. They're often also combining our processor technology with both Mali graphics and physical IP technology from ARM.

Talking of physical IP technology, during the quarter we signed our first license for our new graphics POP IP product. And that optimizes the implementation of the Mali graphics processor.

Also we reached the milestone of our 100th royalty-bearing physical IP platform, again something that bodes well for future growth in physical IP royalties.

So for me, of course, this is all very exciting as more and more chips incorporate multiple technologies from ARM. It's a great base for us to build on for the future.

And with that I'll hand over to Tim who'll provide some more details on the numbers.

Tim Score - *ARM Holdings plc - CFO*

Thanks, Simon. Morning, everyone. Hopefully many of you have had a chance to have a brief review of our Q1 earnings release and the financial details therein. And the quarterly slides that you're used to seeing is on the website to help you review your models. So I'm not going to go into masses amounts of detail on the numbers. Warren's touched on a lot of them. But I will provide a little bit of color to help as we think about the balance of the year.

So processor license revenue in Q1 was \$81m, lower than Q4 2012 when we reported \$85m, but on the positive side of my guidance that I gave with the Q4 results for quarterly license revenue of plus or minus \$75m. And looking out for the balance of the year, that remains the guidance, plus or minus \$75m for license revenue.

Going into Q1, the backlog was at record levels. And we exited the quarter with backlog up about 5% sequentially. In this quarter, Q1, over 70% of PD license revenues were generated from the backlog, a higher contribution than the normal range that we typically see of 40% to 60%. Given this relatively high contribution from backlog to the strong license revenue number reported in Q1, it is very encouraging to see the order backlog increase again sequentially, indicative of another very strong bookings quarter in Q1.

The usual analysis of backlog maturity and composition is included in the slide set that I mentioned. And it shows that approximately 25% of total backlog is expected to be recognized as revenue over the next two quarters.



Processor royalties once again outperformed the industry in Q1, up 33% year on year against an industry that was broadly up around 2%, so a bigger differential than we have typically seen, which is usually more in the 15% to 20% range but, as Warren says, probably flattered to some extent by the semiconductor inventory correction at the back end of 2011, which was reported in our royalties in 2012.

Looking at operating expenses, the headline normalized OpEx in the first quarter was GBP74.6m. And after taking into account foreign exchange mark-to-market credit of around \$4m, offset by two or three smaller one-off items, I think the appropriate base for normalized OpEx when thinking about forecasts for the balance of the year is about GBP76m for Q1, broadly in line with consensus coming into these results. And given, as Warren said, that we are still investing in our research and development capability and our business infrastructure, normalized operating expenses in the second quarter, assuming effective exchange rates similar to current levels, expected to be in the range of GBP77m to GBP79m, I think consistent with the current consensus for Q2 which is about GBP78m.

A little bit of color on tax. The headline normalized rate in the first quarter was just under 17%. You may recall from my comments at the Q4 results that we didn't recognize the benefit of the US federal R&D tax credits in 2012 because that legislation was enacted at the very beginning of January rather than at the end of December, which is typical, and therefore the 2012 benefit of US R&D tax credits has fallen into the first quarter this year. And that's why the Q1 rate is lower than the rate that we are forecasting for the balance of the year, which is just under 20%.

And that reflects the introduction and the partial benefit that we now will be receiving in 2013 for the Patent Box legislation in the UK which is effective from April. And you will remember from previous presentations that the full benefit gets introduced over five years, with 60% of the benefit coming in year one. So we'll be getting effectively nine months of 60% of the benefit from Patent Box this year. So our full-year rate expected to be just under 20%.

Looking forward and reiterating what Warren has already said, we've made an encouraging start to 2013. And more companies are deploying ARM technology in their products. And we therefore expect Group revenues for this year to be at least in line with current market expectations. And relevant industry data for the first quarter, i.e. our shipment period for ARM's Q2 royalties, points to the sequential decrease of 10% in industry-wide revenue that Warren referred to. And in this context we expect Group revenues for the second quarter to be in line with current expectations, which are just over 250m or 253m, 254m is the current expectation for the second quarter, which we are confirming we expect to be in line with.

And with that I'll hand over to questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Gareth Jenkins. Please ask your question.

Gareth Jenkins - UBS - Analyst

Thanks. A few if I could. Firstly I just noticed the licensing of [SCRIMA] high-end graphics. And I just wondered whether you expect an upward drift in graphics ASP over time similar to what we've seen on the mobile side and the processor side.

Secondly, I wonder if you could just give us a sense, Warren or Simon, in terms of the catch rates of Mali within tablets and low-end smartphones. It feels like you're seeing a very real impact of that market taking off and I just wonder whether you could give us a sense of whether it's DTV driving it or whether it's low-end tablets and smartphones that's really driving that Mali volume forwards.

And then finally just on PIPD royalties, again really quite strong in the quarter. I just wonder whether we're now at an inflection in terms of royalty revenues on PIPD. Thank you.



Warren East - *ARM Holdings plc - CEO*

Yes, right. Okay. Let me start, Gareth, and I'll chat about Mali and then we'll ask Simon to comment on those physical IP royalties. So yes, good that you've noticed the licensing of [SCRIMA]. There's no specific guidance here on royalties going forward in our graphics products. But the general principle is if there's more value in the product that we're licensing then we do charge more. The next-generation graphics processors do deliver more value than the previous generation graphics processors. And so exactly the same sort of trajectory that we've seen in our general purpose processors, where when there's more value added there's a higher rate of royalty associated with it, we -- our plan is to continue to execute that with our graphics processors. So as we license more of the next-generation graphics processors, hopefully we're going to sign those licenses with incrementally higher royalty rates.

And the second question about Mali was what's really driving the volumes here. And I think the answer is both. As we've commented before, our graphics presence is relatively strong in what -- digital TVs, as we see as a greenfield area for graphics, and it's very encouraging that our share in digital TVs is very strong for Mali.

But you're right. In the more cost-effective smartphones and in the lower-priced tablets we are very strong as well. And last year we saw Mali being in 60% of the world's Android tablets. That trend is continuing. And as the low-end smartphones continue to grow then we're seeing more Mali there. So the trajectory of Mali volume increase is driven by all of those things.

Simon, would you like to comment on the physical IP royalties?

Simon Segars - *ARM Holdings plc - President & CEO Designate*

Yes. So as you've observed, the royalty growth has been strong. And a lot of that does come from the work we've been doing over the last many years to develop technology for leading-edge processes and develop technology, such as POP IP, to allow our customers to get a more optimal implementation of an ARM core and now the Mali graphics core as well in their SoC.

So the fruits of that work are starting to come through in the royalty, and that's driving the growth. Quite a significant proportion of physical IP royalty now comes from advanced technologies, 40 nanometer, 32 nanometer, 28 nanometer and so on. And we'd expect to see some continued growth there as all of the design-ins that have been going on over the last few years do come to fruition and the wafers start shipping.

Gareth Jenkins - *UBS - Analyst*

Thanks, guys.

Operator

Your next question comes from Didier Scemama. Please ask your question.

Didier Scemama - *BofA Merrill Lynch - Analyst*

Yes. Good morning, gentlemen. Thanks for taking my questions. A couple of quick ones. First maybe a question for Tim on licensing. I just was wondering why you were not a bit more optimistic on licensing growth given the presumably initial recognition of 64-bit licenses over the course of this year. That would be my first question.

And secondly, just a question on the broader ARM ecosystem. It seems as though TSMC is going to start making 20-nanometer wafers already towards the later part of this year and is bringing forward 60-nanometer FinFET. Do you have a sense of when the ARM ecosystem will start producing



60-nanometer FinFET chips, and perhaps associated with 64 bits, just so that we understand where you are relative to your main competitor? Thank you.

Tim Score - *ARM Holdings plc - CFO*

Yes, Didier, on licensing, obviously, as you know, licensing is potentially quite lumpy and the guidance I give is to try and take into account how we see the backlog maturing into revenue and how we see our opportunity pipeline unfolding in future quarters. You can see from last quarter in Q4, which is \$85m. In the two quarters before that we did \$67m and \$69m. And now we've done an \$81m. So it's quite hard and it's going to move around a bit.

Observing the consensus coming into these results, I note that effectively licensing consensus averages out at about \$79m to \$80m per quarter. And relative to the guidance of \$75m plus or minus, that's already on the upside. So I don't think it's sensible this early in the year to fan the flames any further than that. There's already an expectation in the market that licensing is going to unfold at the top end of my guidance and I think that's broadly the appropriate level.

There will be quarters where license starts with an 8, like we've just seen. There will be quarters where it starts with a 7, and we shouldn't be concerned about that. So that's why I'm reiterating the \$75m plus or minus.

Didier Scemama - *BofA Merrill Lynch - Analyst*

That makes sense. Thank you.

Simon Segars - *ARM Holdings plc - President & CEO Designate*

I'll take the question on FinFETs and availability for the ARM ecosystem. So yes, the foundries are continuing to invest aggressively in their development of FinFET technology. I think two weeks ago TSMC had their annual forum here in San Jose and reiterated their expectation that their 16 FinFET technology would go into risk production at the end of this year. Now what risk production in TSMC-speak typically means is that their very early adopter customers would be in a position to tape out some devices.

Now we've been working with them, we've been working with others on making sure that the ARM ecosystem is going to get the best out of FinFET technology. We announced a couple of weeks ago that we had collaborated with TSMC on an early tape-out of Cortex-A57 on their 16 FinFET process. So that's running in the fab right now and we'll see the results from that a bit later this year.

So I think the ARM ecosystem is set to take advantage of FinFET technology. And I think the development schedules from the foundries are progressing well. And so I think the timing of that is about right for the kind of SoCs that our partners want to build.

Didier Scemama - *BofA Merrill Lynch - Analyst*

Yes. Brilliant. And then maybe just one quick follow-up. Is it fair to assume that you have yet to see the benefit of the licensing you've done recently in the base station and router market in networking division, because you had very strong volume growth year over year but I would have thought you have not yet seen those share gains coming in your P&L yet.

Warren East - *ARM Holdings plc - CEO*

That's correct. Absolutely, Didier. You've seen the order book increasing. Part of that is due to v8 licensing. Some of these networking designs are where companies have taken v8 licenses. We've seen the first of those products really launched this year. I mentioned LSI's product launch. They were at Mobile World Congress with the product.



Didier Scemama - *BofA Merrill Lynch - Analyst*

Brilliant. Many thanks.

Warren East - *ARM Holdings plc - CEO*

In February. So it's to come.

Didier Scemama - *BofA Merrill Lynch - Analyst*

Thanks.

Operator

Your next question comes from Sandeep Deshpande. Please ask your question.

Sandeep Deshpande - *JPMorgan - Analyst*

Yes. Hi. I have a question for Tim. A couple of questions, Tim. When we look at your revenues on a year-on-year basis, your revenue is up very strongly but your gross margin is down. Can you talk a little -- talk us through this gross margin dynamic?

And secondly on your operating expenses as well, how should we be looking at operating expenses in Q2? You have guided. But there is some dynamics in Q1 which I would like to understand what happened on their costs in Q1 and how you see this OpEx going through 2013.

Tim Score - *ARM Holdings plc - CFO*

Well on the gross margins, if you look at it back over the last [N] quarters, you'll see that the gross margin vacillates between 94% and 96%. And there are a number of variables in there, service revenue where engineering cost time is applied to service revenues. There are some bought-in parts on the software tools business. And in the physical IP division some engineering time is split between cost of sales and OpEx depending on the precise nature of the projects being undertaken. And it's really those factors combined contribute as to whether the answer is 94% plus or 96% minus. But it's a fairly narrow range in which we operate.

Sandeep Deshpande - *JPMorgan - Analyst*

So you're saying that the higher percentage of royalties as a percentage of revenue is not helping the gross margin?

Tim Score - *ARM Holdings plc - CFO*

I don't think I referred to that at all actually. But then obviously in the long term, as royalties increase as proportionate over revenue, that is an underlying positive driver. But precisely the question around why 94%, why not 95%, those are the short-term reasons.

Sandeep Deshpande - *JPMorgan - Analyst*

Okay.



Tim Score - *ARM Holdings plc - CFO*

On OpEx, as I say, Q1 headline was GBP74.6m. Q1 base for forecasting forward is GBP76m. We had an FX mark-to-market credit of about GBP4m in the first quarter. We also had about an aggregation of about GBP2.5m worth of things offsetting that, a couple of doubtful debt provisions and a minor settlement cost of a legal case which don't normally recur, which is why I'm drawing out GBP76m as the appropriate base. And with the ongoing increase in our headcount, we're guiding GBP78m for the second quarter, consistent with, I think, what's already in the market.

Sandeep Deshpande - *JPMorgan - Analyst*

And then one final follow-up. Would you comment on the -- you grew very strongly in terms of your royalty units with [max controller], etc., which is why the royalty per device was flat year on year. But would you comment on how you -- because you probably see it, how the royalty per device did in the mobile space?

Warren East - *ARM Holdings plc - CEO*

Yes, Sandeep. We won't comment specifically on the mobile space. But we have in the presentation, which is on the website, given you a waterfall chart showing the positive contributions and the downward contribution from the different sectors.

So we have, building off where we were 12 months ago, an uplift of getting on for a cent, a cent and a half, based on higher value chips going into home and mobile and mobile computing, and about another half a cent from the positive contribution in Mali.

And then we got negatives from microcontroller growth and from the lower cost connectivity and touch screen chips in mobile, which brings it back to flat over the year. But as you know, the answer just simply depends on the relative volumes of those buckets.

But the little chart is shown in the slide on the website.

Sandeep Deshpande - *JPMorgan - Analyst*

Thank you.

Operator

Your next question comes from the line of Andrew Gardiner. Please ask your question.

Andrew Gardiner - *Barclays Capital - Analyst*

Good morning. Thank you.

I had a question regarding the -- where we are in terms of the v8 licensing process. I mean, you are clearly highlighting, I think, in the release here that mobile and tablets continue to be sort of key end market, but are you seeing your partner sign-up for a broader range of end markets at the moment? And also, what is the latest in terms of when you expect the actual commercial silicon the market for some of the initial chips?

Thank you.



Warren East - *ARM Holdings plc - CEO*

Okay, this is Warren, and I will answer that. We are seeing v8 taken up for some of the other markets as well, so for servers and for LAN networking, you know, we are seeing A57 being licensed there and we have had another v8 architecture licensee for this enterprise base as well.

So we are seeing, obviously, that licensing activity, it will be at least a couple of years before we see any silicon from those licenses.

Some of the very early licenses, however, we are getting close to silicon, and we are starting to see trial silicon from initial v8 architecture licenses and we would expect some of the initial implementations to be in silicon before the back end of this year.

It is really a 2014 phenomenon, as far as royalty is concerned though, if anything you see in 2013 is going to be very, very first silicon.

Andrew Gardiner - *Barclays Capital - Analyst*

Understood. Thank you.

Warren East - *ARM Holdings plc - CEO*

Okay.

Operator

Your next question comes from Francois Meunier, please ask your question.

Francois Meunier - *Morgan Stanley - Analyst*

Yes, thank you, guys, for taking my question.

First, an operational question, maybe, for a change. The headcount went up something like 13% in Q1 mostly with engineers, could you please explain what type of engineers you hired like you know, newbies ore more experiment people, maybe, where they come from?

And how is your -- how difficult is it to integrate those new guys, probably from, you know, other organization into something which is still a bit of a starter I would say.

And that is my first question, thank you.

Warren East - *ARM Holdings plc - CEO*

Okay, I will answer that, Francois. I think probably the 13% you refer to is year on year. We hired 69 people during the quarter.

So if we look year on year at the people that we have hired, then just over a third are graduates and you know, it's important that we hire graduates and get these people and train them. The remainder are more experienced people.

The areas of the business that they are going into are primarily microprocessor, general purpose microprocessor design teams and specifically over the last 12 months, we have been growing graphics business as well and the graphics resource.



Last year, we also hired a small number of people for the first time in several years, we hired a small number of people, some tens of people into physical IP division and that is because you will see we have been growing the activity there. And as Simon described, the emphasis there is very much on the leading-edge technology. We needed some more resource to do that as well.

Geographically, the ratios are up by a constant with roughly 40% of that hiring being in the UK. So that is where most of the hiring goes.

As Tim mentioned, as we scale up the business, we do need to hire some people into more of a sort of the infrastructure of the business to you know, enhance our IT capability, and so that our engineers can be more productive.

We don't experience any specific difficulties. The absolute number of people that ARM needs to hire is relatively small compared with some of the big semiconductor companies and so we are able to access the talent that we need.

Francois Meunier - *Morgan Stanley - Analyst*

Okay, very good.

And Warren, as well, I think in your opening remarks, you talked about both the internet of things and wearable technologies. How big do you think this market could become in terms of the mix? Is it more Cortex M market or a Cortex A market?

Warren East - *ARM Holdings plc - CEO*

Yes, well, I will start and then maybe Simon can make a comment on that as well.

I mean, I think the answer is both. You know, we are seeing microcontrollers typically, when we talk about local centers and so on, then you know, we are saying it's very much microcontrollers.

You know, however, you know, this quarter, we have seen a Cortex A 5-phase microcontroller family launched from one of our partners when we get into wearable technology, and obviously, that demands a little bit more of a user interface and so I think we probably see some A class processes going into those as well.

But I don't know if, Simon, you want to add anything to that?

Simon Segars - *ARM Holdings plc - President & CEO Designate*

Yes, I mean I think a lot of the initial application is for wearable technology are going to be M-class and with a lot of connectivity to a mobile phone. And so if you take some of the applications like the Nike Fuelband for example, that has a small display built in but really the idea is that you track your data on your mobile device and I think you are going to see a lot of that.

I mean, in our partner's microcontroller products, their Cortex A based microcontrollers are and lots and lots of M class, and so there is a whole wide range of performance spectrum, I mean, many hundreds of megahertz Cortex A8 based devices being shipped by TI for example, as well as all the M class that Warren mentioned in his talk there.

So -- but I think the wearable, and -- I think a lot of that will be M and it is -- the device is basically going to contain some form of sensor to determine what you are doing and some form of connectivity to your phone, and a very small battery and the whole thing will be built for very low power.



APRIL 23, 2013 / 7:30AM, ARM.L - Q1 2013 ARM Holdings plc Earnings Conference Call

Francois Meunier - Morgan Stanley - Analyst

Okay.

Simon Segars - ARM Holdings plc - President & CEO Designate

In the market, that can be very big. I happen to be sat next to a guy from a textiles company on a flight the other day, and we got chatting and he said he was doing kind of the high end textile sort of sporting equipment. And he said all his customers wanted to integrate our technology, ARM's technology with his technology. So I think it's going to be a big market.

Francois Meunier - Morgan Stanley - Analyst

Okay, thank you very much.

Operator

Your next question comes from Simon Schafer. Please ask your question.

Simon Schafer - Goldman Sachs Group Inc - Analyst

Yes, thanks so much. I wanted to ask a follow up question on PIPD royalties. I know you sort of have alluded already that TSMC and now the people strength roadmaps are benefitting you in terms of unit momentum. But I think in Q1, you saw something like a 30-point spread compared to industry growth, i.e. [disciplined] growth that you guys, I think the foundry industry only growing 20. Is that a sustainable runrate in terms of being able to outgrow the industry or does that change or even see a step function as 22-nanometer gets introduced and even lower down?

Warren East - ARM Holdings plc - CEO

Yes, thanks, Simon.

Simon, I think, it would be probably best if you comment on that?

Simon Segars - ARM Holdings plc - President & CEO Designate

Yes. I think that when you look at the foundry market, there are lots of mature technologies, you know, there is still an awful lot of wafers shipped every day on 0.18 micron, 0.25 micron and even 0.35 micron. And our Physical IP business has quite a large installed base there.

So I would expect that to be -- that portion of the royalties to be fairly constant, you know, slightly growing up and down as the industry kind of ebbs and flows.

But again, in that area, there is the big opportunity around these micro controllers for a lot more growth. But you know, there is obviously a lot of action now at the more advanced technology nodes, and as the process nodes themselves get more complex and it gets harder and harder to build any form of chip utilizing that technology, then more of our partners are looking for anything - any help they can get and that is where the pop IPs becoming so popular.

And so, you know, I think with the designs that we have, the momentum that we have [defined] that technology, the licensing that we have done on the advanced nodes at the foundries, then I do think there is potential for us to grow at a faster rate than the foundry industry as a whole.



Simon Schafer - Goldman Sachs Group Inc - Analyst

Got it. Thank you.

And the same question, it would just be on the -- just quality and an anatomy, if you will, of the PD licenses number. I think you said 70% of the license number in the quarter was recognized from backlog.

I mean, more broadly, is there a risk that your backlog starts to go down? I know it's up plenty in the second half of last year specifically. But it just seems like an unusually high percentage to be recognizing from backlog. Is there a risk in that?

Tim Score - ARM Holdings plc - CFO

No, I don't think so, Simon. I think in any quarter, you know, the license revenue number is going to be comprised partly of contribution from backlog and partly from you know, turned business where revenue is recognizable immediately.

And I think, you know, in different quarters, depending on the nature of the deals and the number of the deals, that the balance will shift and as we say, if you look back over the last few quarters, 50% to 60% is more difficult. This one was 70 because you know, we had some engineering [masked under the mat] that yielded revenue but as I said in my comments, the fact that that backlog was more than topped out by bookings which didn't yield revenue in the quarter, you know, I think is very encouraging as we look forward.

And I wouldn't expect typically, the contribution from backlog to be beyond the norm now so out of the normal range of 40 to 60, I think this is probably quite an unusual quarter. But it is very reassuring that the backlog still went up sequentially.

Simon Schafer - Goldman Sachs Group Inc - Analyst

Okay. Thanks, Tim.

Operator

Your next question comes from Sumant Wahi, please ask your question.

Sumant Wahi - Redburn Partners LLP - Analyst

Hi, thanks for taking my questions.

I guess I had two -- one actually was on the market share gains, you reported in this quarter. I'm just trying to understand really -- I mean you say that it's primarily driven by embedded businesses and then you made the comment on the fact that the base station hasn't really started showing up in your royalty.

So I was wondering if you could give us a little bit of a color on which aspects of the non-mobile market essentially are the drivers for this market share gains? Are we talking microcontrollers, TVs, networking equipment, so that is really my first question.

And then I have a follow up on patent box, but I'll let you answer this one first.



Warren East - ARM Holdings plc - CEO

Let me answer that one, so it's yes. If you look at the 2.6 billion chips reported as shipped by our partners in the reporting quarter, then, the market share gains that we're seeing are primarily in microcontrollers, digital TVs. I mean, just put some color on that and we've got this data on the website as well.

You know, overall chip shipments are ARM up 35%; industry up 7%; mobile up 20% per ARM industry flattish minus 1%. Microcontrollers, ARM up 40%; industry up 20%. Digital TVs, ARM up 100%; industry up 10%. And for storage, ARM up 20%; industry up 10%. So, there isn't any enterprise networking to speak of in those numbers.

The networking share gains that we're seeing at the moment are ARM's traditional networking areas, which is very much sort of consumer home networking, ADSL, modems, and those sort of things. The gains in enterprise networking are all at the design-in stage and licensing at the moment. And the benefit that we'll see from that in royalties is yet to come.

Sumant Wahi

Okay, thank you.

And I mean, just a quick one on that, you know Simon mentioned that the wearable market could be a significant over there. I mean, is there any possibility of giving a rough idea of how we can quantify that? I mean, is that big enough to actually be in another line on your Analyst Day the way you that you could split up the whole market. Do you think this variable technology could actually be another line over there? Is it that big?

Warren East - ARM Holdings plc - CEO

I can tell you, the Analyst Day material is in preparation and we haven't got anything on that in the Analyst Day material specifically. In years to come, maybe we'll see but it's far too early to talk about scaling that right now.

Sumant Wahi

Okay.

Tim Score - ARM Holdings plc - CFO

Sumant, I'm including those things in the microcontroller market.

Sumant Wahi

Okay. Okay. Cool.

And then I think I have a quick follow-up on the patent box side. If I understand that law correctly, it probably allows for a much lower tax rate on royalties which are achieved from patents signed or may -- registered in the UK. So I was wondering from a long-term strategic point of view, does that really change your sort of hiring or investment strategy in the coming years?

I know that you mentioned only 40% of your new hires are in the UK but I was just wondering the way it would affect your tax rate blended, would this change the way you invest in UK?



Tim Score - *ARM Holdings plc - CFO*

No I don't think so, Sumant.

I mean, the way we structure our affairs in our patent ownership is actually that most of our technology is already owned naturally out of the UK. We've structured it in that fashion in years gone by pre-patent box.

So I think it's unlikely that this type of tax legislation would influence our overall sort of strategic approach to resourcing. But in a sense, almost fortuitously, if you like, a lot of our qualifying profits from this legislation already come out of the UK.

Sumant Wahi

That's because the historic patents you signed and the way your business works essentially. Is that --

Tim Score - *ARM Holdings plc - CFO*

It's the way we structured the ownership of our patents, yes.

Sumant Wahi

Okay. Thank you very much.

Operator

Your next question comes from the line of Kai Korschelt. Please ask your question.

Kai Korschelt - *Deutsche Bank - Analyst*

Yes. Hi. Thanks for taking my question. I had a couple. The first one was -- just going back to this slide 14 where the ASP bridge for the end process effectively.

It does seem to suggest that enterprise is currently a drag on chip ASP. I'm just curious, I would have thought that the ASPs in that market are fairly high. So, I'm just wondering why there seemed to be a drag on the \$0.048.

Warren East - *ARM Holdings plc - CEO*

Yes --

Kai Korschelt - *Deutsche Bank - Analyst*

Yes, my second question was just on the tax rate. Not entirely sure but it sounds like this US legislation is maybe new and it seems to be an addition to the UK regulations.

So, I'm just wondering what you think your blended tax rates, you know, could be next year and maybe in three years as a consequence of both the UK and the US patent box. Thank you.



Tim Score - *ARM Holdings plc - CFO*

Let's do last in first out, shall we on that one?

On the tax, I mean the US R&D tax credit which I referred to is not new, Kai.

I mean, the issue is typically -- yes, we've been receiving R&D tax credits based on our US R&D effort for a number of years. It just so happens that in 2012, the legislation was not enacted in the year. It's enacted on January 2, and therefore we couldn't recognize the benefit of those R&D tax credits coming out of the US until Q1 2013, which is why we had a slightly higher rate in Q4 2012 and a slightly lower rate in Q1 2013.

I mean, looking forward, so you know, accepting if you like, that that issue doesn't impact, the thing that does impact is obviously the full realization of the patent box benefits.

And again, I said earlier, they're at about 60% of the benefits accrued in the first year. And it was introduced in April. So, we're getting 8/12th of them, 9/12th of them in 2013.

And I think I showed that at the Analysts Day last year or the year before that the tax rate would continue to gradually go down from current levels. And I think in due course, in the out years, you can expect it to be in the sort of mid -- just over mid teens area, all other things being equal.

Warren East - *ARM Holdings plc - CEO*

Okay.

And let me just explain the chart that you referred to there, Kai.

Yes, enterprise. What we mean by enterprise in this particular context, it's about the storage chips. As I said, the network infrastructure and the service piece is not really contributing to royalties yet.

So, at that particular enterprise being you'll note storage overall industry up 10%, ARM up 20% as we gain share in the solid-state disk drives market, as PCs are switching more to solid-state disks, and those are low-cost devices for us, and that's what's responsible for that part of the chart.

Kai Korschelt - *Deutsche Bank - Analyst*

Okay. Thank you for the color. Thanks.

Operator

Your next question comes from Janardan Menon. Please ask your question.

Janardan Menon - *Liberum Capital - Analyst*

Hi. Thanks for taking the question.

I just want to go back to the outlook for licensing. Tim, over the last two years, you've given guidance over range and the reality is that ARM has sort of blown past that guidance, taking the licensing number higher and higher into the next range of \$10 million and so forth.



When you look at your current outlook and you've given a range which is going to likely start through the 7 or an 8, have you sort of gone through the sort of diversification of all the applications into new areas and signing up a number of architectural licenses in the last couple of years, which makes it less likely that you are going to beat these numbers very significantly which has moved into the nines or something like that, and are you going to be more in line with your long-term guidance of sort of mid to high-single digit growth rate?

Second -- the second question I had was just on your Q1 results.

You had guided the revenues down to 250 and with an implication of royalties being down in the quarter, I was just wondering where -- what surprised you in the quarter, what came in much higher than your initial expectations at the beginning of that quarter?

Was it more on the smartphone side or was it more on the sort of embedded processing side of things?

John Buchanan - *ARM Holdings plc - Chairman*

Yes. John, here.

No. I think, I mean, again, you heard me say before that I think, well, obviously, we're going through -- we have been going through in the last couple of years, a very strong period of license growth.

And there were a lot of questions over the last few quarters about whether this was sustainable, whether it was a short peak or will our Christmases be coming at once or a post downturn bounce or whatever.

And what we've said is looking forward from this higher base, the medium term outlook for licensing is, as you said, mid to high-single digit. I mean, that's what we see as the longer run, sustainable growth rate for our processor licensing.

I mean, what is a little bit harder to call is the exact transition period from the much higher licensing that we've enjoyed over the last couple of years to that longer-term rate. But taking all that into account, as I say, I still think 75 plus or minus, when we're looking out over the next few quarters, is the right way to think about it. So, I think, that's the answer on licensing.

Warren East - *ARM Holdings plc - CEO*

And on your other question, I'm not sure that I'm interpreting the question correctly. Are you referring to the quarter that we're just reporting or what lies behind guidance for Q2, the previous.

Janardan Menon - *Liberum Capital - Analyst*

No, the quarter that you just reported.

Warren East - *ARM Holdings plc - CEO*

Yes. So, I mean, actually as we said in the numbers, the upside is across the fees. The royalty numbers reported absolutely a little bit higher but I think you know, you're seeing seasonality in the smartphone piece and strong market share gains in the microcontrollers and embedded. As simple as that.



Janardan Menon - *Liberum Capital - Analyst*

Okay. Is your visibility any different for different parts of the business? I mean, you have some visibility now as you go into the quarter, you sort of get initial receipts from your customers which gives you an idea of what the quarter is likely to look like. As you are sort of diversifying your revenue base, do you have similar levels of visibility to give that guidance or is it very much different for different segments?

Warren East - *ARM Holdings plc - CEO*

Well, I mean, in terms of the direct reporting from our partners, they report -- they have 90 days after the end of the quarter to report the chips shipped during that preceding quarter.

As we sit here on the 23rd of the month, we have relatively few royalty reports in from our 120-odd royalty payers. By the time we get through to sort of two-thirds of the ways through the quarter, we've had most of the royalty reports in and so we've got direct information.

If you think about what's feeding our guidance today, we're drawing people's attention to the fact that companies who have already reported their Q1 combined with companies who haven't reported yet but have already guided their Q1, that's where we're coming up with a sort of minus 10% for the industry at large.

If you think about color on that, it's rather more commentary around some of the higher profile companies supplying chips into the mobile space, into tablets, and those sorts of things.

Many of our customers who are starting to ship ARM in microcontrollers, these are -- many of them are small companies who are not such high profile and so we don't get such a lot of commentary and analysis on those companies.

So, if you wanted to look for a longer-term trend as we diversify our customer base more and get more exposed to these companies that, frankly, the analysts' community doesn't cover in such detail, then there's less sort of ancillary color.

Hopefully, that painted a view as to where we get our data from and how it builds up.

Janardan Menon - *Liberum Capital - Analyst*

Got it. Thank you very much.

Warren East - *ARM Holdings plc - CEO*

Thank you.

Operator

Your next question comes from Jerome Ramel. Please ask your question.

Jerome Ramel - *Exane BNP Paribas - Analyst*

Yes. Good morning.

Can you give us a little bit more color of the dynamic with big. LITTLE? When you expect to see some royalty revenues coming from big. LITTLE and the collection with clients?



Warren East - ARM Holdings plc - CEO

Yes. I'll kick off. Simon, you may want to add some color on to this.

I mean, the first big.LITTLE implementations will be A15, A7 combinations. We saw the leading companies with those showing off their wares at initially at the Mobile World Congress back in February. And as I have said, these are very sort of early things which are showing off in the Mobile World Congress will not really be in production until the back end of this year at the very earliest.

And so in terms of you noticing any impact in royalty, it is probably going to be a next year thing rather than a 2013, perhaps very much to the back end of this year.

Simon, do you want to add some color on that and maybe on the v8 big.LITTLE combination?

Simon Segars - ARM Holdings plc - President & CEO Designate

Sure, yes. I mean I would agree with Warren there about, you know, products being shipped late this year so royalty is starting to flow right at the end of the year or into Q1 next year.

And but when you look at the licensing momentum behind big.LITTLE, you know, we got something like 17 big.LITTLE customers right now, as Warren said initially, that Cortex A15 plus Cortex A7 combinations.

But big.LITTLE is a technology that spans multiple architectures and so we had v8 --version8 architecture, big.LITTLE customers as well, and in fact, three of the licenses that we did in Q1 were for big.LITTLE combinations and Cortex A57 plus Cortex A53 to form that same big.LITTLE pairing.

So as a technology, you know, we are expecting to see this in many devices being able to switch between very high performance processors and then very small processors optimized for power, I think is going to be a vital tool for providing increased performance whilst managing power consumption in an end device.

Ian Thornton - ARM Holdings plc - Head of IR

Okay, thanks, Simon. I think we got time for just one more question, please.

Operator

Your next question comes from Matt Ramsey, please ask your question.

Matt Ramsey - Canaccord - Analyst

Good morning. Thanks very much. I just wanted to follow up on the graphics question that were asked earlier with Mali up 5x year-over-year. You talked a bit about the digital TV market but in the smartphone market in particular, maybe you could comment on your potential for future share gains given that some of your processor partners in the space seem pretty set with their graphics plan going forward, with -- maybe Qualcomm and Cupertino dominating most of the high end share that is not Samsung and Mediatech and Qualcomm's QRD looking to take a lot of shares at the low end of the market.

So maybe you could talk about some share gain opportunities going forward for Mali and Mobile? Thanks.



Warren East - *ARM Holdings plc - CEO*

Yes, so I will deal with that.

Well, I mean you are absolutely right in your observation. You know, Qualcomm have their own solution and they are very wedded to their own solution and Qualcomm are enjoying a lot of success at the moment with their integrated devices and the fact that they are ahead of the curve in LTE modems.

So, clearly, from a Mali graphics point of view, in mobile, that is a headwind for us.

That said, other chip suppliers are benefiting from the tremendous growth in demand that we are seeing for lower end smartphones in developing regions. You know, people are expecting smartphones across the piece to continue to grow very strongly this year.

And that growth overall is tapering, but nobody could possibly describe a 40% growth in the number of smartphones in the year as being in any way, modest. That is very significant growth.

And the high end solutions of course, being sold in to you know, the developed regions of the world, clearly growth is much lower there. And so the activity is happening in the emerging regions, the faster-growing economies of the world, and they are lower priced phones and they are chipsets from a broader range of semiconductor companies and many of these companies do use Mali and that is a driver for our expected growth in Mali as we look forward to this year and next year.

Meanwhile, digital TV as you observed in these numbers, our growth compared with that of the market is very, very strong. Our share in digital TV, for Mali, is very, very strong as well and so putting those two things together, you know, we are seeing some growth from that.

And you got all the low cost tablet as well.

So that is what is fueling it, and you know, we said, with the results last time, this year, we expect Mali volumes to increase from around 150m units in 2012 to at least 250m units this year. Hopefully, some of these markets that I just described will make that grow even more. We will wait and see.

Matt Ramsey - *Canaccord - Analyst*

All right. Thank you very much.

Warren East - *ARM Holdings plc - CEO*

OK, so, with that thank you very much for all your questions and for dialing in.

As noted at the start of the call, this is actually the last time you're going to hear from me reporting these results.

So, thank you for everybody for your support over the last multiple quarters. And the business in great shape going forward.

And meanwhile the rest of the team will be back to tell you all about it in July. So, thank you very much.

Operator

That does conclude the conference for today. Thank you for participating. You may now disconnect.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2013, Thomson Reuters. All Rights Reserved.

PRELIMINARY TRANSCRIPT

