

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

For the quarter ended September 30, 2013

of

ARRIS GROUP, INC.

**A Delaware Corporation
IRS Employer Identification No. 46-1965727
SEC File Number 000-31254**

**3871 Lakefield Drive
Suwanee, GA 30024
(678) 473-2000**

ARRIS Group, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

ARRIS Group, Inc. is a large accelerated filer and is not a shell company.

ARRIS is required to submit electronically and post on its corporate web site Interactive Data Files required to be submitted and posted pursuant to Rule 405 of regulation S-T.

As of October 31, 2013, 138,305,785 shares of the registrant's Common Stock, \$0.01 par value, were outstanding.

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ARRIS GROUP, INC.
FORM 10-Q
For the Three and Nine Months Ended September 30, 2013

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Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****ARRIS GROUP, INC.
CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data) (unaudited)

	<u>September 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 541,114	\$ 131,703
Short-term investments, at fair value	125,387	398,414
Total cash, cash equivalents and short-term investments	666,501	530,117
Restricted cash	1,817	4,722
Accounts receivable (net of allowances for doubtful accounts of \$1,713 in 2013 and \$1,630 in 2012)	627,844	188,581
Other receivables	4,076	350
Inventories (net of reserves of \$32,974 in 2013 and \$9,977 in 2012)	350,919	133,848
Prepaid income taxes	49,447	9,235
Prepays	18,881	11,682
Current deferred income taxes, net	85,373	24,944
Other current assets	60,171	16,413
Total current assets	1,865,029	919,892
Property, plant and equipment (net of accumulated depreciation of \$170,309 in 2013 and \$151,836 in 2012)	410,047	54,378
Goodwill	926,826	194,115
Intangible assets (net of accumulated amortization of \$361,257 in 2013 and \$239,668 in 2012)	1,239,178	94,529
Investments	79,894	86,164
Noncurrent deferred income taxes, net	12,680	47,431
Other assets	52,300	9,385
	<u>\$ 4,585,954</u>	<u>\$ 1,405,894</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 573,673	\$ 45,719
Accrued compensation, benefits and related taxes	101,233	29,773
Accrued warranty	48,619	2,882
Deferred revenue	77,267	44,428
Current portion of long-term debt	293,399	222,124
Current income taxes liability	5,827	853
Other accrued liabilities	147,195	24,942
Total current liabilities	1,247,213	370,721
Long-term debt, net of current portion	1,822,941	-
Accrued pension	61,349	26,883
Noncurrent income tax liability	25,012	24,389
Noncurrent deferred income taxes, net	76,005	351
Other noncurrent liabilities	57,335	23,162
Total liabilities	<u>3,289,855</u>	<u>445,506</u>
Stockholders' Equity:		
Preferred stock, par value \$1.00 per share, 5.0 million shares authorized; none issued and outstanding	-	-
Common stock, par value \$0.01 per share, 320.0 million shares authorized; 138.3 million and 114.1 million shares issued and outstanding in 2013 and 2012, respectively	1,729	1,488
Capital in excess of par value	1,669,667	1,285,575
Treasury stock at cost, 34.2 million shares in 2013 and 2012	(306,330)	(306,330)
Accumulated deficit	(56,189)	(11,809)
Unrealized gain on marketable securities (net of accumulated tax expense of \$52 in 2013 and \$125 in 2012)	85	206
Unfunded pension liability (net of accumulated tax effect of \$2,272 in 2013 and 2012)	(8,558)	(8,558)
Unrealized loss on derivative instruments (net of accumulated tax effect of \$2,450 in 2013)	(4,277)	-
Cumulative translation adjustments	(28)	(184)
Total stockholders' equity	<u>1,296,099</u>	<u>960,388</u>
	<u>\$ 4,585,954</u>	<u>\$ 1,405,894</u>

See accompanying notes to the condensed consolidated financial statements.

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ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data and percentages) (unaudited)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net sales	\$ 1,067,823	\$ 357,432	\$ 2,421,835	\$ 1,009,660
Cost of sales	750,831	245,480	1,765,240	670,274
Gross margin	316,992	111,952	656,595	339,386
Operating expenses:				
Selling, general and administrative expenses	99,557	37,866	227,458	117,544
Research and development expenses	128,579	42,978	296,061	130,006
Restructuring charges	6,057	213	38,323	6,455
Acquisition and other costs	6,221	30	32,803	1,076
Amortization of intangible assets	64,606	7,742	127,751	22,565
Total operating expenses	305,020	88,829	722,396	277,646
Operating income (loss)	11,972	23,123	(65,801)	61,740
Other expense (income):				
Interest expense	25,188	4,479	48,431	13,251
Gain on investments	(251)	(878)	(1,544)	(1,482)
Interest income	(832)	(764)	(2,310)	(2,248)
(Gain) loss on foreign currency	(3,752)	(431)	(2,725)	916
Other expense (income), net	1,676	(129)	13,356	(791)
Income (loss) before income taxes	(10,057)	20,846	(121,009)	52,094
Income tax (benefit) expense	(28,016)	2,982	(76,629)	13,430
Net income (loss)	<u>\$ 17,959</u>	<u>\$ 17,864</u>	<u>\$ (44,380)</u>	<u>\$ 38,664</u>
Net income (loss) per common share:				
Basic	<u>\$ 0.13</u>	<u>\$ 0.16</u>	<u>\$ (0.34)</u>	<u>\$ 0.34</u>
Diluted	<u>\$ 0.13</u>	<u>\$ 0.15</u>	<u>\$ (0.34)</u>	<u>\$ 0.33</u>
Weighted average common shares:				
Basic	<u>138,478</u>	<u>113,709</u>	<u>129,502</u>	<u>114,206</u>
Diluted	<u>140,605</u>	<u>116,346</u>	<u>129,502</u>	<u>116,348</u>

See accompanying notes to the condensed consolidated financial statements.

ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss)	\$ 17,959	\$ 17,864	\$ (44,380)	\$ 38,664
Unrealized gain (loss) on marketable securities, net of tax (benefit) expense of \$30 and \$(41) for the three months ended September 30, 2013 and 2012, and \$(73) and \$221 for the nine months ended September 30, 2013 and 2012, respectively	104	(137)	(121)	341
Unrealized loss on derivative instruments, net of tax benefit of \$2,450 for the three and nine months ended September 30, 2013	(4,277)	-	(4,277)	-
Cumulative translation adjustment	(331)	-	156	-
Comprehensive income (loss), net of tax	<u>\$ 13,455</u>	<u>\$ 17,727</u>	<u>\$ (48,622)</u>	<u>\$ 39,005</u>

See accompanying notes to the condensed consolidated financial statements.

ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands) (unaudited)

	Nine Months Ended September 30,	
	2013	2012
Operating activities:		
Net (loss) income	\$ (44,380)	\$ 38,664
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	41,824	20,965
Amortization of intangible assets	127,751	22,565
Stock compensation expense	24,653	21,194
Deferred income tax benefit	(54,551)	(10,904)
Amortization of deferred finance fees and debt discount	4,999	479
Provision for doubtful accounts	5	54
Gain on investments	(1,544)	(1,482)
Revenue reduction related to Comcast's investment in ARRIS	13,182	-
Mark-to-market fair value adjustment related to Comcast's investment in ARRIS	13,189	-
Loss on disposal of product line	-	337
Loss on disposal of fixed assets	375	40
Non-cash restructuring and related charges	6,761	-
Excess income tax benefits from stock-based compensation plans	(6,417)	(2,614)
Non-cash interest expense	9,926	9,177
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	17,793	(19,515)
Other receivables	1,095	8,187
Inventories	60,345	(25,139)
Income taxes payable and recoverable	(37,720)	1,943
Accounts payable and accrued liabilities	155,265	2,614
Prepays and other, net	47,498	6,043
Net cash provided by operating activities	380,049	72,608
Investing activities:		
Purchases of property, plant and equipment	(53,383)	(14,520)
Sale of property, plant and equipment	90	13
Purchases of investments	(104,547)	(235,348)
Sales of investments	393,234	172,059
Cash paid for acquisition, net of cash acquired	(2,208,114)	-
Sale of product line	-	3,249
Net cash used in investing activities	(1,972,720)	(74,547)
Financing activities:		
Repurchase of common stock	-	(51,921)
Excess income tax benefits from stock-based compensation plans	6,417	2,614
Repurchase of shares to satisfy employee tax withholdings	(12,522)	(8,184)
Proceeds from issuance of common stock	166,951	12,208
Proceeds from issuance of debt	1,925,000	-
Payment of debt obligations	(31,625)	-
Cash paid for debt discount	(9,853)	-
Early redemption of convertible notes	(79)	-
Deferred financing costs paid	(42,207)	-
Net cash provided by (used in) by financing activities	2,002,082	(45,283)
Net increase (decrease) in cash and cash equivalents	409,411	(47,222)
Cash and cash equivalents at beginning of period	131,703	235,875
Cash and cash equivalents at end of period	\$ 541,114	\$ 188,653

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Supplemental cash flow information:

As part of the acquisition agreement entered into with the Motorola Home acquisition, in the third quarter of 2013 the Company received \$85 million in cash for indemnification of certain retained litigation by the seller for which the Company remitted payment of \$85 million as settlement. This has been reflected in the cash flows from operating activities.

In addition to the \$85 million discussed in the aforementioned paragraph, the Company also settled a retained litigation for \$196 million, \$50 million of which was paid directly by the Company and the remaining indemnified and paid by Google. Since the Company had the right to receive the cash from Google and the obligation to pay the amount to a third party, we have included the gross amounts in the cash flows from operating activities.

See accompanying notes to the condensed consolidated financial statements

ARRIS GROUP, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Organization and Basis of Presentation

ARRIS Group, Inc. (together with its consolidated subsidiaries, except as the context otherwise indicates, “ARRIS” or the “Company”) is a premier video and broadband technology company that transforms how service providers worldwide deliver entertainment and communications without boundaries. Its powerful end-to-end platforms enable service and content providers to improve the way people connect – with each other and with their favorite content. The Company’s vision and expertise continue to drive the industry’s innovations, as they have for more than 60 years. Headquartered north of Atlanta, in Suwanee, Georgia, ARRIS has R&D, sales and support centers throughout the world.

ARRIS operates in two business segments, Network and Cloud (“N&C”) and Customer Premises Equipment (“CPE”). (See Note 16 *Segment Information* for additional details) ARRIS specializes in integrated broadband network solutions that include products, systems software and systems integration services for multiscreen video delivery, user interfaces, content security, processing and management, video on demand and network operations management. ARRIS is a leading developer, manufacturer and supplier of telephony, data, video, construction, rebuild and maintenance equipment for broadband communications service providers including telephone companies and cable system operators. In addition, ARRIS is a leading supplier of infrastructure products used by cable system operators to build-out and maintain hybrid fiber-coaxial (“HFC”) networks. ARRIS also manufactures video encoding, processing, and storage equipment used by service providers, programmers, and internet video distributors. ARRIS broadband modem products also are sold directly to consumers through retail stores and internet outlets. The Company provides its customers with products and services that enable reliable transmission of video and high speed two-way broadband data and telephony.

On April 17, 2013, the Company completed its acquisition of Motorola Home from General Instrument Holdings, Inc., a subsidiary of Google, Inc. (See Note 3 *Business Acquisitions* for additional details.)

The condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for a fair presentation of the consolidated financial statements for the periods shown. Certain balance sheet and cash flow line items in prior periods have been reclassified to conform to the current financial statement presentation. Interim results of operations are not necessarily indicative of results to be expected from a twelve-month period. These financial statements should be read in conjunction with the Company’s most recently audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the United States Securities and Exchange Commission (“SEC”).

Note 2. Recent Accounting Pronouncements

Adoption of New Accounting Standards - In February 2013, the Financial Accounting Standards Board (“FASB”) issued an accounting standards update that adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. This update requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., the release due to cash flow hedges from interest rate contracts) and the income statement line items affected by the reclassification (e.g., interest income or interest expense). If a component is not required to be reclassified to net income in its entirety (e.g., the net periodic pension cost), companies would instead cross reference to the related footnote for additional information (e.g., the pension footnote). This update was adopted by ARRIS beginning in the first quarter of 2013. The adoption of this guidance did not have a material impact on our consolidated financial position and results of operations.

In December 2011, FASB issued guidance that requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. In January 2013, the FASB issued guidance to clarify the scope of the disclosures about offsetting assets and liabilities guidance. The guidance is effective for annual periods beginning on or after January 1, 2013. This update was adopted by ARRIS beginning in the first quarter of 2013. The adoption of this guidance did not have a material impact on our consolidated financial position and results of operations.

Accounting Standards Issued But Not Yet Effective - In July 2013, the FASB issued an accounting standard update which provides that an unrecognized tax benefit, or a portion thereof, should be presented in the financial statements

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as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013.

Accounting pronouncements issued but not in effect until after September 30, 2013 are not expected to have a significant impact on our consolidated financial position or results of operations.

Note 3. Business Acquisitions

Acquisition of Motorola Home

On April 17, 2013, ARRIS completed its acquisition of Motorola Home from General Instrument Holdings, Inc. (“Seller”), a subsidiary of Google, Inc. Consideration for the acquisition consisted of approximately \$2,208.1 million in cash, inclusive of working capital adjustments, and 10.6 million shares of ARRIS’ common stock (the “Acquisition”).

The Acquisition enhanced the Company’s scale and product breadth in the telecom industry and diversified the Company’s customer base and expanded dramatically the Company’s international presence. Notably, the acquisition brought to ARRIS, Motorola Home’s product scale and scope in end-to-end video processing and delivery, including a full range of QAM and IP set top box products, as well as IP Gateway CPE equipment for data and voice services for broadband service providers. The Acquisition also enhanced the depth and scale of the Company’s R&D capabilities, particularly in the video arena, and approximately doubled the Company’s patent portfolio to nearly 2,000 patents and patent applications. In addition, via a license, the Company was provided access to approximately 20,000 Motorola Mobility patents as they relate to Motorola Home.

The following table summarizes the fair value of consideration transferred for Motorola Home, net of cash acquired (in thousands):

Cash transferred ⁽¹⁾	\$2,208,114
Fair value of Shares issued to Seller ⁽²⁾	176,410
Total value of consideration	\$2,384,524

- (1) At closing the actual cash transferred as part of the transaction was \$2,159.8 million, net of cash acquired of \$78.0 million. During the quarter ended September 30, 2013, an additional \$48.3 million of cash was transferred as part of working capital adjustments. The cash portion of the consideration was funded with cash on hand, borrowings under ARRIS’ senior secured credit facilities (see Note 14 *Long-Term Indebtedness* for additional details) and through the sale by ARRIS of approximately 10.6 million shares of ARRIS’ common stock to a subsidiary of Comcast Corporation for \$150 million in cash.
- (2) The fair value of the 10.6 million shares issued to Seller was determined based on the opening price of the Company’s common stock at the Acquisition date.

The Acquisition has been accounted for using the acquisition method of accounting in accordance with the business combinations guidance, which requires, among other things, that the assets acquired and liabilities assumed be recognized at their acquisition date fair values, with any excess of the consideration transferred over the estimated fair values of the identifiable net assets acquired recorded as goodwill.

The following table summarizes the preliminary estimated fair values of the net assets acquired as of the acquisition date, as well as measurement period and other adjustments made during 2013 to the amounts initially recorded. The measurement period adjustments have been retrospectively adjusted in our financial statements as if those adjustments occurred on the acquisition date. Certain estimated fair values are not yet finalized (see below) and are subject to change, which could be significant. We will finalize the amounts recognized as we obtain the information necessary to complete the analysis, but no later than one year from the acquisition date.

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(in thousands)	Amounts Recognized as of Acquisition Date (a)	Adjustments	Amounts Recognized as of Acquisition Date (as adjusted)
Total consideration transferred, net of cash acquired (b)	\$ 2,336,172	\$ 48,352	\$ 2,384,524
Assets acquired and liabilities assumed:			
Accounts receivable	462,162	–	462,162
Inventories	279,562	(2,146)	277,416
Deferred income tax assets (c)	370,543	14,558	385,101
Other assets	153,094	(2,073)	151,021
Property, plant & equipment	350,547	790	351,337
Intangible assets (d)	1,343,400	(107,100)	1,236,300
Accounts payable	(349,235)	–	(349,235)
Deferred revenue	(27,797)	–	(27,797)
Other liabilities (e)	(324,852)	(17,745)	(342,597)
Deferred tax liability (c)	(534,479)	42,326	(492,153)
Total net assets acquired	<u>1,722,945</u>	<u>(71,390)</u>	<u>1,651,555</u>
Goodwill (f)	<u>\$ 613,227</u>	<u>\$ 119,742</u>	<u>\$ 732,969</u>

(a) As previously reported as of June 30, 2013.

(b) Amount represents adjustment for final working capital.

(c) The measurement period and other adjustments for deferred tax assets and liabilities primarily reflect the tax impact of the pre-tax measurement period adjustments and adjustments to certain uncertain tax positions following receipt of additional information about facts and circumstances existing as of the acquisition date.

(d) The measurement period adjustments for identifiable intangible assets primarily consists of adjustments recorded to reflect changes in the estimated fair value of certain acquired intangibles, principally customer relationships, developed technology and patents, and in-process research and development based upon facts and circumstances that existed as of the acquisition date. The Company continued to gather further specific information on the Motorola Home intangible assets, such as the timing and risk of cash flows of the intangible assets, including those assets still in the research and development phase. Some of the more significant assumptions inherent in the development of intangible asset values, from the perspective of a market participant, include: the amount and timing of projected future cash flows (including revenue, cost of sales, research and development costs, sales and marketing expenses); working capital; contributory asset charges; the discount rate selected to measure the risks inherent in the future cash flows; and the assessment of the asset's life cycle and the competitive trends impacting the asset, as well as other factors. These factors were refined in order to further complete the valuation work that impacted (i) the estimated total fair value assigned to intangible assets, (ii) the estimated assignment of fair value between finite-lived and indefinite-lived intangible assets and/or (iii) the estimated weighted-average useful life of each category of intangible assets.

(e) The change primarily relates to an increase in warranty accrual due to a change in estimate of the initial accrued warranty recorded at the acquisition date as a result of additional information arising subsequent to the acquisition that existed as of the Acquisition date.

(f) Goodwill recognized as of the acquisition date (as adjusted) totaled \$733 million and is attributable to the workforce of the acquired business, strategic opportunities and synergies that are expected to arise from the acquisition of Motorola Home. The preliminarily determined goodwill has been assigned to the Company's three reporting units (see Note 4 *Goodwill and Intangible Assets* for additional details). These amounts are not yet finalized and are subject to change. With the exception of \$71.4 million of goodwill that retains its tax basis after the acquisition, the remaining portion of the \$733.0 million of goodwill is not expected to be deductible for income tax purposes. The amount of tax deductible goodwill remains subject to adjustment through the measurement period.

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The Company recognizes an increase or decrease in the provisional amounts recognized for identifiable asset (liability) by means of a decrease or increase in goodwill. We performed a careful evaluation of the adjustments made to the provisional amounts recognized to determine whether the potential adjustment is the result of information that existed as of the acquisition date or whether the adjustment is the result of events occurring subsequent to the acquisition date. As such, the Company only adjusted the provisional amounts for facts and circumstances that existed at the acquisition date.

As of September 30, 2013, the initial accounting for certain items is incomplete. Specifically, the following items are subject to change:

- Amounts for intangible assets and property, plant and equipment, pending finalization of valuation efforts and receipt of final valuation report from the third party valuation specialist.
- Amounts for income tax assets, receivables and liabilities pending the filing of pre-acquisition tax returns, as well as the receipt of information from taxing authorities, which may change certain estimates and assumptions used.
- The final assignment of goodwill among reporting units.

During the measurement period, the Company will adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date and ARRIS will record those adjustments to the financial statements.

Certain tax attributes will not likely be known until tax returns of acquired entities are filed. It is possible some tax returns may not be filed until after the measurement period. Therefore, there is likelihood that certain deferred tax assets and/or liabilities related to tax attributes may be recorded outside the measurement period.

The \$1.2 billion of acquired intangible assets preliminarily was assigned to the following (in thousands):

	Fair value	Estimated Weighted Average Life (years)
Customer relationships	\$ 642,900	8
Developed technology and patents	436,800	6
In process R&D	93,200	indefinite
Backlog	44,600	1
Trademark / trade name	18,800	1
Total	<u>\$1,236,300</u>	

In connection with the Acquisition, the Seller agreed to indemnify ARRIS for a portion of certain potential liabilities from certain intellectual property infringement litigation claims. As a result, the Company recorded at the date of acquisition a \$70 million liability related to one of these litigation claims and an indemnification asset of \$70 million related to this liability. The litigation claim subsequently was settled for \$85 million, for which ARRIS was fully indemnified. The Company also recorded a \$13.9 million liability at the date of acquisition related to an infringement lawsuit included as part of \$50.0 million of potential liability retained by ARRIS pursuant to the acquisition agreement. This lawsuit settled subsequent to the date of acquisition. See Note 22 *Contingencies* for additional details.

The fair value of accounts receivable was \$462.2 million, with the gross contractual amount being \$470.9 million. The Company expects \$8.7 million to be uncollectible.

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The Company incurred acquisition related costs of \$6.2 million and \$32.8 million, during the three and nine months ended September 30, 2013, respectively. These amounts were expensed by the Company as incurred and are included in the Consolidated Statement of Operations in the line item titled "Acquisition and other costs".

The Motorola Home business contributed revenues of approximately \$1,292 million to our consolidated results from the date of acquisition through September 30, 2013.

The following unaudited pro forma summary presents consolidated information of the Company as if the acquisition of Motorola Home occurred on January 1, 2012, the beginning of the comparable prior annual period. The pro forma adjustments primarily relate to the depreciation expense on stepped-up fixed assets, amortization of acquired intangibles, interest expense related to new financing arrangements and the estimated impact on the Company's income tax provision. The unaudited pro forma combined results of operations are provided for illustrative purposes only and are not indicative of the Company's actual consolidated results. The Motorola Home business was consolidated by ARRIS for the entire three month period ended September 30, 2013; therefore no pro forma financial information has been presented. In addition, unaudited pro forma net loss for the nine months ended September 30, 2013 was adjusted to exclude \$18.4 million of acquisition related costs and \$55.4 million of expense related to the fair value adjustment to acquisition-date inventory. Unaudited pro forma net loss for the nine months ended September 30, 2012 was adjusted to include these charges. In addition, unaudited pro forma net loss for the three and nine months ended September 30, 2012 includes \$3.2 million and \$10.3 million reduction in revenue, respectively, related to the fair value adjustment to deferred revenue. These adjustments exclude the income tax impact.

(in thousands)	Three months Ended	Nine Months Ended	
	September 30, 2012	September 30, 2013	2012
Net sales	\$ 1,158,212	\$3,227,656	\$3,519,316
Net loss	(34,891)	(100,054)	(130,733)
Net loss per common share			
Basic	\$ (0.26)	\$ (0.70)	\$ (0.97)
Diluted	\$ (0.26)	\$ (0.70)	\$ (0.97)

These pro forma results are based on estimates and assumptions that the Company believes are reasonable.

Note 4. Goodwill and Intangible Assets

Goodwill

As of September 30, 2013, the Company has recorded goodwill of \$926.8 million. Effective in the second quarter of 2013, the Company changed its operating segments due to a change in its underlying organizational model designed to support the business following the Acquisition (see Note 16 - *Segment Information*). The Company did not operate under the realigned operating segment structure prior to the second quarter of 2013. This change in segments resulted in a reassignment of goodwill amongst some of the Company's reporting units. Prior period information has been retrospectively adjusted to reflect this reassignment. For purposes of goodwill and impairment testing, the Company has determined that it has three reporting units based on the organizational structure, the financial information that is provided to and reviewed by segment management and aggregation criteria applicable to component business that are economically similar. For the CPE operating segment, the reporting unit is the same as the operating segment. The Network & Cloud operating segment is comprised of two reporting units, which are Network Infrastructure and Cloud Services.

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The following is a summary of the Company's goodwill (in thousands), reflecting the retrospective reassignment as of December 31, 2012:

CPE	\$ 31,850
Network Infrastructure	162,265
Cloud Services	—
Balance as of December 31, 2012	<u>\$ 194,115</u>

During 2013, the Company recorded additional goodwill of \$733.0 million related to the Acquisition. The Company has preliminarily assigned the assets and liabilities acquired to each of its identified reporting units. The Company intends to finalize the assignment of the goodwill from the Acquisition during fiscal year 2013.

The changes in the carrying amount of goodwill for the year to date period ended September 30, 2013 are as follows (in thousands):

	CPE	Network Infrastructure	Cloud Services	Total
Goodwill	\$ 31,850	\$ 419,318	\$ 121,603	\$ 572,771
Accumulated impairment losses	—	(257,053)	(121,603)	(378,656)
Balance as of December 31, 2012:	<u>\$ 31,850</u>	<u>\$ 162,265</u>	<u>\$ —</u>	<u>\$ 194,115</u>
Goodwill acquired during the year (preliminarily assigned)	646,360	83,917	2,692	732,969
Adjustment to deferred tax asset – C-COR	—	(258)	—	(258)
Goodwill	678,210	502,977	124,295	1,305,482
Accumulated impairment losses	—	(257,053)	(121,603)	(378,656)
Balance as of September 30, 2013:	<u>\$ 678,210</u>	<u>\$ 245,924</u>	<u>\$ 2,692</u>	<u>\$ 926,826</u>

Intangible Assets

The gross carrying amount and accumulated amortization of the Company's intangible assets as of September 30, 2013 and December 31, 2012 are as follows (in thousands):

	September 30, 2013				December 31, 2012			
	Gross Amount	Accumulated Amortization	Net Book Value	Weighted Average Remaining Life (Years)	Gross Amount	Accumulated Amortization	Net Book Value	Weighted Average Remaining Life (Years)
Customer relationships	\$ 892,909	\$ 240,693	\$ 652,216	7.2	\$ 250,009	\$ 190,285	\$ 59,724	4.0
Developed technology & patents	550,126	93,918	456,208	5.2	77,769	42,964	34,805	4.4
Trademarks	20,900	6,204	14,696	1.7	257	257	—	—
Order backlog	44,600	20,442	24,158	0.5	3,000	3,000	—	—
Non-compete agreements	—	—	—	—	3,162	3,162	—	—
In-process R&D	91,900	—	91,900	—	—	—	—	—
Total	<u>\$ 1,600,435</u>	<u>\$ 361,257</u>	<u>\$ 1,239,178</u>		<u>\$ 334,197</u>	<u>\$ 239,668</u>	<u>\$ 94,529</u>	

The Company preliminarily recorded approximately \$1,236.3 million of identifiable intangible assets in conjunction with the Acquisition.

The Company recognized acquired in-process research and development assets of \$93.2 million associated with the Acquisition, which initially is recognized at fair value and classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts. Accordingly, during the development period after the acquisition date, this asset was not amortized as a charge to earnings; instead these assets were subject to periodic impairment testing. During the quarter ended September 30, 2013, acquired in-process research and development projects of \$1.3 million were successfully completed. The Company determined no impairment existed with regard to the asset. The asset was then considered a finite-lived intangible asset and reclassified as part of developed technology and amortization of the asset commenced.

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Amortization expense is reported in the consolidated statements of operations within operating expenses under the caption “Amortization of intangible assets.” The estimated future amortization expense related to intangible assets with a finite life as of September 30, 2013, is as follows (in thousands):

2013 (for the remaining three months)	\$ 64,337
2014	220,365
2015	199,994
2016	169,363
2017	152,588
2018	114,055
Thereafter	226,577

Note 5. Comcast Investment in ARRIS

In connection with the Acquisition, Comcast Corporation (“Comcast”) was given an opportunity to invest in ARRIS. On January 11, 2013, ARRIS entered into a separate agreement accounted for as a contingent equity forward with a subsidiary of Comcast providing for the purchase of approximately 10.6 million shares of the Company’s common stock for \$150 million, or \$14.11 per share. The transaction with Comcast was contingent upon on the closing of the Acquisition.

As provided for in the definitive agreement for the Acquisition, the shares issued to Comcast reduced, on a share-for-share basis, the number of shares of ARRIS stock issued to Google and simultaneously increased the cash consideration paid to Google by \$150.0 million. As a result of the sale of common stock to Comcast, both Comcast and Google each own approximately 7.7% of ARRIS outstanding shares post-closing of the Acquisition. The Comcast transaction was consummated on the same day as the Acquisition. Because the amount of shares issued to Comcast was not fixed when the agreement was executed, but prior thereto, the agreement with Comcast is classified as a liability in accordance with the accounting guidance for derivatives and hedging.

At the time the agreement was executed with Comcast on January 11, 2013, the Company’s stock price was \$15.35 per share. However, consistent with earlier negotiations, Comcast agreed to invest in ARRIS at the same price as Google, which was \$14.11 per share. The revenue recognition accounting guidance requires that the Company recognize the intrinsic value of the benefit received by Comcast - the entitlement to invest at a price below the market price (\$14.11 per share as opposed to the then-market price of \$15.35 per share) on the date the agreement with Comcast was executed - as a reduction of revenue. As such, revenue and gross margin were reduced by approximately \$13.2 million during the first quarter 2013.

Because the obligation under the agreement was not indexed to the Company’s stock and does not meet the definition of a derivative, the Company elected to subsequently account for the obligation at fair value by electing the fair value option. That is, the Company has marked-to-market the obligation at each reporting period. This resulted in a mark-to-market income adjustment of \$13.2 million expense in the first half of 2013. This mark-to-market adjustment is recorded as Other (Income).

Upon settlement of the contract in the second quarter of 2013, the Company recorded the issuance of its common stock to Comcast, which is included in stockholders’ equity on the Consolidated Balance Sheets.

Note 6. Investments

ARRIS' investments consisted of the following (in thousands):

	As of September 30, 2013	As of December 31, 2012
Current Assets:		
Available-for-sale securities	<u>\$ 125,387</u>	<u>\$ 398,414</u>
Noncurrent Assets:		
Available-for-sale securities	33,054	59,549
Equity method investments	17,489	—
Cost method investments	6,000	6,000
Other investments	<u>23,351</u>	<u>20,615</u>
	79,894	86,164
Total	<u>\$ 205,281</u>	<u>\$ 484,578</u>

Available-for-sale securities - ARRIS' investments in debt and marketable equity securities are categorized as available-for-sale and are carried at fair value. The Company currently does not hold any held-to-maturity securities. Realized gains and losses on available-for-sale securities are included in net income. Unrealized gains and losses on available-for-sale securities are included in the Consolidated Balance Sheets as a component of accumulated other comprehensive income (loss). The total gains included in the accumulated other comprehensive income related to available-for-sale securities were \$85 thousand and \$0.2 million, net of tax, as of September 30, 2013 and December 31, 2012, respectively. Realized and unrealized gains and losses in total and by individual investment as of September 30, 2013 and December 31, 2012 were not material. The amortized cost basis of the Company's investments approximates fair value.

Equity method investments - In connection with the Acquisition, ARRIS acquired certain investments in joint ventures, limited liability companies, and partnerships that are accounted for using the equity method as the Company has significant influence over operating and financial policies of the investee companies. The carrying amount of equity method investments are increased for the Company's proportionate share of the investees' earnings and decreased for the Company's proportionate share of the investees' losses or for dividends received from the investees.

Cost method investments - ARRIS holds cost method investments in private companies. These investments are recorded at \$6.0 million as of September 30, 2013 and December 31, 2012. Due to the fact the investments are in private companies, ARRIS is exempt from estimating the fair value on an interim and annual basis. It is not practical to estimate the fair value since the quoted market price is not available. Furthermore, the cost of obtaining an independent valuation appears excessive considering the investments are not material to the Company. However, ARRIS is required to estimate the fair value if there has been an identifiable event or change in circumstance that may have a significant adverse effect on the fair value of the investment.

Other investments - At September 30, 2013 and December 31, 2012, ARRIS held \$23.4 million and \$20.6 million, respectively, in certain life insurance contracts. This investment is classified as non-current investments in the Consolidated Balance Sheet. The Company determined the fair value to be the amount that could be realized under the insurance contract as of each reporting period. The changes in the fair value of these contracts are included in net income.

Other-Than-Temporary Investment Impairments - ARRIS concluded that no other-than-temporary impairment losses existed as of September 30, 2013. In making this determination, ARRIS evaluates its investments for any other-than-temporary impairment on a quarterly basis considering all available evidence, including changes in general market conditions, specific industry and individual entity data, the financial condition and the near-term prospects of the entity issuing the security, and the Company's ability and intent to hold the investment until recovery. For the year ended December 31, 2012, ARRIS recognized other-than-temporary impairment charges of \$1.5 million in the statements of consolidated income.

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Classification of securities as current or non-current is dependent upon management's intended holding period, the security's maturity date and liquidity consideration based on market conditions. If management intends to hold the securities for longer than one year as of the balance sheet date, they are classified as non-current.

Maturity Information - The contractual maturities of the Company's investments as of September 30, 2013 are shown below. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. The amortized cost basis of the Company's investments approximates fair value (in thousands):

	September 30, 2013
Due in one year or less	\$ 153,298
Due after one year through five years	45,965
Due after five years	6,018
	<u>\$ 205,281</u>

Note 7. Fair Value Measurement

Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). The authoritative guidance establishes a fair value hierarchy that is based on the extent and level of judgment used to estimate the fair value of assets and liabilities. In order to increase consistency and comparability in fair value measurements, the FASB has established a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. An asset or liability's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the measurement of its fair value. The three levels of input defined by the authoritative guidance are as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The following table presents the Company's investment assets and interest rate swap positions measured at fair value on a recurring basis as of September 30, 2013 (in thousands):

	Level 1	Level 2	Level 3	Total
<i>Current Assets:</i>				
Certificates of deposit	\$ —	\$ 3,759	\$ —	\$ 3,759
Commercial paper	—	6,981	—	6,981
Corporate bonds	—	85,190	—	85,190
Short-term bond fund	29,457	—	—	29,457
	<u>29,457</u>	<u>95,930</u>	<u>—</u>	<u>125,387</u>
<i>Noncurrent Assets:</i>				
Cash surrender value of company owned life insurance	—	23,324	—	23,324
Corporate bonds	—	28,477	—	28,477
Corporate obligations	—	18	—	18
Money markets	226	—	—	226
Mutual funds	204	—	—	204
Other investments	—	4,156	—	4,156
	<u>430</u>	<u>55,975</u>	<u>—</u>	<u>56,405</u>
Total assets	<u>\$29,887</u>	<u>\$151,905</u>	<u>\$ —</u>	<u>\$181,792</u>

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The following table presents the Company's investment assets measured at fair value on a recurring basis as of December 31, 2012 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<i>Current Assets:</i>				
Certificates of deposit	\$ –	\$ 5,416	\$ –	\$ 5,416
Commercial paper	–	18,964	–	18,964
Corporate bonds	–	209,093	–	209,093
Municipal bonds	164,941	–	–	164,941
	<u>164,941</u>	<u>233,473</u>	<u>–</u>	<u>398,414</u>
<i>Noncurrent Assets:</i>				
Cash surrender value of company owned life insurance	–	20,615	–	20,615
Corporate bonds	–	53,914	–	53,914
Corporate obligations	–	15	–	15
Money markets	226	–	–	226
Mutual funds	179	–	–	179
Other investments	–	5,215	–	5,215
	<u>405</u>	<u>79,759</u>	<u>–</u>	<u>80,164</u>
Total assets	<u>\$165,346</u>	<u>\$ 313,232</u>	<u>\$ –</u>	<u>\$478,578</u>

In addition to the amounts disclosed in the above table, the fair value of the Company's Israeli severance pay assets, which were almost fully comprised of Level 2 assets, was \$4.0 million and \$3.8 million as of September 30, 2013 and December 31, 2012, respectively.

All of the Company's short-term and long-term investments at September 30, 2013 are classified within Level 1 or Level 2 of the fair value hierarchy as they are valued using quoted market prices, market prices for similar securities, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include the Company's investment in money market funds, mutual funds, government agency bonds and municipal bonds. Such instruments are generally classified within Level 1 of the fair value hierarchy. The types of instruments valued based on other observable inputs include the Company's cash surrender value of company owned life insurance, corporate obligations and bonds, bond funds, commercial paper and certificates of deposit. Such instruments are classified within Level 2 of the fair value hierarchy.

In determining the value of certain Level 2 instruments, ARRIS has performed steps to verify the accuracy of the valuations provided by ARRIS' brokerage firms. ARRIS has reviewed the most recent Statement on Standards for Attestation Engagements No. 16 (SSAE report) for each brokerage firm holding investments for ARRIS. The SSAE report for each did not identify any control weakness in the brokerages' policies and procedures, in particular as they relate to the pricing and valuation of financial instruments. ARRIS has determined the third party pricing source used by each firm to be a reliable recognized source of financial valuations. In addition ARRIS has performed further testing on a large sample of its corporate obligations and commercial paper investments. These tests did not show any material discrepancies in the valuations provided by the brokerage firms. It is the Company's intent to continue to verify valuations on a quarterly basis, using one or more reliable recognized third party pricing providers. See Note 6 *Investments* and Note 8 *Derivative Instruments and Hedging Activities* for further information on the Company's investments and derivative instruments and hedging activities.

In addition to the financial instruments included in the above table, certain nonfinancial assets and liabilities are to be measured at fair value on a nonrecurring basis in accordance with applicable authoritative guidance. This includes items such as nonfinancial assets and liabilities initially measured at fair value in a business combination

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(but not measured at fair value in subsequent periods) and nonfinancial long-lived asset groups measured at fair value for an impairment assessment. In general, nonfinancial assets including goodwill, other intangible assets and property and equipment are measured at fair value when there is an indication of impairment and are recorded at fair value only when any impairment is recognized. As of September 30, 2013, the Company had not recorded any impairment related to such assets and had no other material nonfinancial assets or liabilities requiring adjustments or write-downs to their current fair value.

The carrying value of debt as of September 30, 2013 approximated the fair value.

Note 8. Derivative Instruments and Hedging Activities

Risk Management Policies – ARRIS is exposed to financial market risk, primarily related to foreign currency and interest rates. These exposures are actively monitored by management. To manage the volatility relating to certain of these exposures, the Company enters into a variety of derivative financial instruments. Management’s objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency and interest rates. ARRIS’ policies and practices are to use derivative financial instruments only to the extent necessary to manage exposures. ARRIS does not hold or issue derivative financial instruments for trading or speculative purposes.

Accounting Policy for Derivative Instruments – The derivatives and hedging accounting standard provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company’s objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

As required by derivatives and hedging guidance, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives also may be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

In accordance with the FASB’s fair value measurement guidance, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

ARRIS recognizes all derivative financial instruments as assets or liabilities in the Consolidated Balance Sheets at fair value. In April 2013, ARRIS entered into senior secured credit facilities having variable interest rates with Bank of America, N.A. and various other institutions, which are comprised of (i) a “Term Loan A Facility” of \$1.1 billion, (ii) a “Term Loan B Facility” of \$825 million and (iii) a “Revolving Credit Facility” of \$250 million. In July 2013, ARRIS entered into six \$100.0 million interest rate swap arrangements, which effectively converted \$600.0 million of the Company’s variable-rate debt based on one-month LIBOR to an aggregate fixed rate of approximately 3.65%. This fixed rate could vary up by 25 basis points or down by 50 basis points based on future changes to the Company’s net leverage ratio. Each of these swaps matures on December 29, 2017. ARRIS has designated these swaps as cash flow hedges, and the objective of these hedges is to manage the variability of cash flows in the interest payments related to the portion of the variable-rate debt designated as being hedged.

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The Company's foreign currency derivative financial instruments are not designated as hedges, and accordingly, all changes in the fair value of the instruments are recognized as a loss (gain) on foreign currency in the Consolidated Statements of Operations.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2013, such derivatives were used to hedge the variable cash flows associated with existing lines of credit. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and nine months ended September 30, 2013, the Company did not have expenses related to hedge ineffectiveness in earnings.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. Over the next 12 months, the Company estimates that an additional \$7.0 million may be reclassified as an increase to interest expense.

As of September 30, 2013, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

<u>Interest Rate Derivative</u>	<u>Number of Instruments</u>	<u>Notional</u>
Interest Rate Swaps	6	\$ 600,000,000

The table below presents the pre-tax impact of the Company's derivative financial instruments had on the Accumulated Other Comprehensive Income and Statement of Operations for the three and nine months ended September 30, 2013 (in thousands):

	<u>Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)</u>	<u>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</u>	<u>Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</u>	<u>Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</u>
Interest rate derivatives	\$ (7,979)	Interest expense	\$ (1,253)	\$ -

Credit-risk-related Contingent Features

ARRIS has agreements with each of its derivative counterparties that contain a provision where the Company could be declared in default on its derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to the Company's default on the indebtedness. As of September 30, 2013, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$6.9 million. As of September 30, 2013 the Company has not posted any collateral related to these agreements.

Non-designated Hedges

Additionally, the Company does not currently use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

Balance Sheet Recognition and Fair Value Measurements - The following table indicates the location on the Consolidated Balance Sheets in which the Company's derivative assets and liabilities have been recognized, the fair value hierarchy level applicable to each derivative type and the related fair values of those derivatives (in thousands).

ARRIS has master netting arrangements with substantially all of ARRIS' counterparties giving ARRIS the right of offset for ARRIS' derivative positions. However, ARRIS has not elected to offset the fair value positions of the derivative contracts recorded on ARRIS' Consolidated Balance Sheets.

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	<u>As of September 30, 2013</u>		<u>As of December 31, 2012</u>	
	<u>Balance Sheet Location</u>	<u>Fair Value</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
<i>Derivatives Not Designated as Hedging Instruments:</i>				
Foreign exchange contracts				
– asset derivatives	Other current assets	\$ –	Other current assets	\$ 590
Foreign exchange contracts				
– liability derivatives	Other accrued liabilities	\$ –	Other accrued liabilities	\$ 513
<i>Derivatives Designated as Hedging Instruments:</i>				
Interest rate derivatives				
– asset derivatives	Other assets	\$ 305	Other assets	\$ –
Interest rate derivatives				
– liability derivatives	Other accrued liabilities	\$ 7,032	Other accrued liabilities	\$ –

The assets and liabilities for the interest rate derivatives were considered as Level 2 under the fair value hierarchy. The assets and liabilities for the foreign exchange contracts were considered as Level 1 under the fair value hierarchy.

The change in the fair values of ARRIS' derivative financial instruments recorded in the Consolidated Statements of Operations during the three and nine months ended September 30, 2013 and 2012 were as follows (in thousands):

	<u>Statement of Operations Location</u>	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
		<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<i>Derivatives Not Designated as Hedging Instruments:</i>					
Foreign exchange contracts	Loss (gain) on foreign currency	\$ –	\$ 142	\$ 428	\$ (66)
<i>Derivatives Designated as Hedging Instruments:</i>					
Interest rates derivatives	Interest Expense	\$ 1,253	\$ –	\$ 1,253	\$ –

Note 9. Pension Benefits

Components of Net Periodic Pension Cost (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Service cost	\$ 310	\$ 84	\$ 637	\$ 251
Interest cost	562	521	1,479	1,563
Expected gain on plan assets	(259)	(315)	(730)	(944)
Amortization of net loss	355	210	829	630
Net periodic pension cost	<u>\$ 968</u>	<u>\$ 500</u>	<u>\$ 2,215</u>	<u>\$ 1,500</u>

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The Company assumed \$32.2 million of pension liability related to a defined benefit plan in Taiwan in connection with the Acquisition. Net period pension cost for the three and nine month periods ended September 30, 2013, includes pension costs of \$0.6 million and \$1.1 million related to this Taiwan pension plan, respectively.

Employer Contributions

No minimum funding contributions are required in 2013 under the Company's defined benefit plan. However, the Company made voluntary contributions to the plan of approximately \$39 thousand and \$145 thousand for the three and nine months ended September 30, 2013. Additionally, the Company made a voluntary contribution to the plan of \$0.2 million in April 2013. The Company has established two rabbi trusts to fund the Company's pension obligations under the non-qualified plan of the Chief Executive Officer and certain executive officers. The balance of these rabbi trust assets as of September 30, 2013 was approximately \$18.9 million and is included in Investments on the Consolidated Balance Sheets.

Note 10. Guarantees

Warranty

ARRIS provides warranties of various lengths to customers based on the specific product and the terms of individual agreements. The Company provides for the estimated cost of product warranties based on historical trends, the embedded base of product in the field, failure rates, and repair costs at the time revenue is recognized. Expenses related to product defects and unusual product warranty problems are recorded in the period that the problem is identified. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers, the estimated warranty obligation could be affected by changes in ongoing product failure rates, material usage and service delivery costs incurred in correcting a product failure, as well as specific product failures outside of ARRIS' baseline experience. If actual product failure rates, material usage or service delivery costs differ from estimates, revisions (which could be material) would be recorded to the warranty liability.

The Company offers extended warranties and support service agreements on certain products. Revenue from these agreements is deferred at the time of the sale and recognized on a straight-line basis over the contract period. Costs of services performed under these types of contracts are charged to expense as incurred, which approximates the timing of the revenue stream.

The Company initially recorded \$65.5 million of warranty obligations as a result of the Acquisition, which included \$10.2 million of known product defects. During the third quarter of 2013, the Company recorded an increase of \$19.4 million in the warranty accrual due to a change in estimate of the initial accrued warranty recorded at the Acquisition date as a result of additional information that arose subsequent to the Acquisition that existed as of the Acquisition date.

Information regarding the changes in ARRIS' aggregate product warranty liabilities for the nine months ended September 30, 2013 was as follows (in thousands):

Balance at December 31, 2012	\$ 6,069
Motorola Home warranty reserve at Acquisition	84,888
Accruals related to warranties (including changes in estimates)	10,133
Settlements made (in cash or in kind)	(22,851)
Balance at September 30, 2013	<u>\$ 78,239</u>

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The following table represents a summary of and changes to the restructuring accrual, which is primarily composed of accrued severance and other employee costs, contractual obligations that related to excess leased facilities and equipment and write off of property, plant and equipment (in thousands):

	Employee severance & termination benefits	Contractual obligations and other	Write-off of property, plant and equipment	Total
Balance at December 31, 2012	\$ —	\$ 1,163	\$ —	\$ 1,163
Balance acquired at Acquisition	—	155	—	155
Restructuring charges	31,536	26	6,761	38,323
Cash payments	(23,602)	(464)	—	(24,066)
Non-cash expense	—	—	(6,761)	(6,761)
Balance at September 30, 2013	<u>\$ 7,934</u>	<u>\$ 880</u>	<u>\$ —</u>	<u>\$ 8,814</u>

Employee severance and termination benefits – In the second quarter of 2013, ARRIS completed its acquisition of Motorola Home. ARRIS initiated restructuring plans as a result of the Acquisition that focuses on the rationalization of personnel, facilities and systems across multiple segments in the ARRIS organization.

The total estimated cost of the restructuring plan was approximately \$31.5 million and was recorded as severance expense during 2013. As of September 30, 2013, the total liability remaining for this restructuring plan was approximately \$7.9 million. The remaining liability is expected to be paid by the end of Q1 2014.

Contractual obligations - ARRIS has restructuring accruals representing contractual obligations that relate to excess leased facilities and equipment.

In the fourth quarter of 2007, ARRIS acquired remaining restructuring accruals of approximately \$0.7 million from C-COR. In the fourth quarter of 2009, an adjustment of \$1.5 million was made related to the sublease assumption for 2010-2014 given the real estate market conditions. As of September 30, 2013, the total liability remaining for this restructuring plan was approximately \$0.5 million. Payments will be made over their remaining lease terms through 2014, unless terminated earlier. This restructuring plan was related to the Network and Cloud segment.

In the fourth quarter of 2011, the acquisition of BigBand Networks resulted in a restructuring charge of \$3.4 million, of which \$3.3 million was related to severance and termination benefits and \$0.1 million was related to facilities. In 2012, ARRIS recorded an additional restructuring charge of \$6.8 million, of which \$5.6 million was related to severance and termination benefits and \$1.2 million was related to facilities. As of September 30, 2013, the total liability remaining for this restructuring plan was approximately \$0.3 million and is related to facilities. This remaining liability will be paid over the remaining lease terms through 2016, unless terminated earlier. This restructuring plan was related to the Network and Cloud segment.

Additionally, in the second quarter of 2013 as part of the Acquisition, ARRIS acquired remaining restructuring accruals of approximately \$0.2 million from Motorola Home. As of September 30, 2013, the total liability remaining for this restructuring plan was approximately \$0.1 million. These payments will be paid over their remaining lease terms through 2018, unless terminated earlier. This restructuring plan was related to the Customer Premises Equipment segment.

Write-off of property, plant & equipment – As part of the restructuring plan initiated as a result of the Acquisition, during the third quarter of 2013 the Company recorded restructuring charges of \$6.8 million related to the write-off of property, plant and equipment associated with rationalization of product lines and enterprise resource planning system integration activities. This restructuring plan was related to the Network and Cloud segment and Corporate.

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Note 12. Inventories

Inventories are stated at the lower of average cost, approximating first-in, first-out, or market. The components of inventory were as follows, net of reserves (in thousands):

	September 30, 2013	December 31, 2012
Raw material	\$ 55,514	\$ 24,798
Work in process	14,030	2,800
Finished goods	281,375	106,250
Total inventories, net	<u>\$ 350,919</u>	<u>\$ 133,848</u>

Note 13. Property, Plant and Equipment

Property, plant and equipment, at cost, consisted of the following (in thousands):

	September 30, 2013	December 31, 2012
Land	\$ 88,742	\$ 2,562
Building and leasehold improvements	127,665	25,995
Machinery and equipment	363,949	177,657
	580,356	206,214
Less: Accumulated depreciation	(170,309)	(151,836)
Total property, plant and equipment, net	<u>\$ 410,047</u>	<u>\$ 54,378</u>

Note 14. Long-Term Indebtedness

Convertible Senior Notes

In 2006, ARRIS issued \$276.0 million of 2% convertible senior notes due 2026 (the "Notes"). The notes may be converted only upon the occurrence of specified events and during specified periods, including (i) from October 15, 2013 to November 15, 2013 and (ii) during any calendar quarter in which the closing price of the Company's common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 120% of the conversion price in effect on the last trading day of the last calendar quarter (which, based on the current conversion price, would be \$19.31). The conversion rate for the Notes, subject to adjustment, is 62.1504 shares per \$1,000 principal amount (which represents an initial conversion price of approximately \$16.09 per share of the Company's common stock). Upon conversion, the holder will receive up to the principal amount in cash and may receive, depending on the price of the Company's common stock, an additional payment, in cash, the Company's common stock or a combination thereof, at the option of the Company. Each component of the conversion consideration is based on a formula that includes the conversion rate and the market price of the Company's common stock during a period following the date of the conversion.

As a result of the holding company reorganization undertaken in connection with the Acquisition, holders of the Notes had the right, (i) to require ARRIS to repurchase the senior notes for 100% of the principal amount of the senior notes, plus accrued and unpaid interest to, but not including the repurchase date or (ii) to convert the senior notes for the consideration described above. In the second quarter of 2013, Notes in the aggregate principal amount

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of \$68 thousand were tendered pursuant to the repurchase right, and \$11 thousand were surrendered pursuant to the conversion right. As a result, approximately \$232.0 million aggregate principal amount of the Notes were outstanding as of September 30, 2013.

On October 17, 2013, the Company announced that it would redeem the Notes for par value on November 15, 2013. On October 15, 2013 the Company also announced that the Notes are convertible at the option of the holders from October 15, 2013 until 11:59 p.m. E.T. on November 15, 2013 for the consideration specified in the indenture (the "Conversion Option"). The Company also announced October 17, 2013 holders of the Notes have an option to require the Company to purchase the Notes for par value on November 15, 2013 (the "Put Option"). None of the Company, its Board of Directors, or its employees or the Trustee has made or is making any representation or recommendation to any holder of Notes as to whether to exercise or refrain from exercising the Conversion Option, the Put Option or Repurchase Option. Any Notes not surrendered pursuant to the Put Option of the Conversion Option will be redeemed on November 15, 2013.

The Notes are unsecured senior obligations of ARRIS and are effectively subordinated to all liabilities, including trade payables and lease obligations of ARRIS' subsidiaries. Interest is payable on May 15 and November 15 of each year. There are no significant financial covenants related to the notes. As of September 30, 2013, the carrying amount of the Notes was \$232.0 million and was recorded in current liabilities on the Company's Consolidated Balance Sheets.

ARRIS accounts for the liability and equity components of the Notes separately. The Company is accreting the debt discount related to the equity component to non-cash interest expense over the estimated seven year life of the Notes, which represents the first redemption date of November 15, 2013 when ARRIS Enterprises may redeem the Notes at its election or the Note holders may require their redemption. The equity and liability components related to the Notes were as follows (in thousands):

	<u>September 30, 2013</u>	<u>December 31, 2012</u>
Carrying amount of the equity component	\$ 48,209	\$ 48,209
Principal amount of the liability component	\$ 231,972	\$ 232,050
Unamortized discount	—	(9,926)
Net carrying amount of the liability component	<u>\$ 231,972</u>	<u>\$ 222,124</u>

The following table presents the contractual interest coupon and the amortization of the discount on the equity component related to the notes during the three and nine months ended September 30, 2013 and 2012 (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Contractual interest recognized	\$ 1,160	\$ 1,160	\$ 3,480	\$ 3,481
Amortization of discount	3,374	3,119	9,926	9,177

The effective annual interest rate on the debt component is 7.93%.

The Company paid approximately \$7.8 million of finance fees related to the issuance of the Notes. Of the \$7.8 million, approximately \$5.3 million was attributed to the debt component and \$2.5 million was attributed to the equity component of the convertible debt instrument. The portion related to the debt component is being amortized over seven years. The finance costs from these notes were fully amortized as of September 30, 2013. The remaining balance of unamortized financing costs as of December 31, 2012 was \$0.6 million. (See Note 23 *Subsequent Events* for additional details.)

The Company has not paid cash dividends on its common stock since its inception.

[Table of Contents](#)*Senior Secured Credit Facilities*

In April 2013, ARRIS entered into senior secured credit facilities with Bank of America, N.A. and various other institutions, which are comprised of (i) a “Term Loan A Facility” of \$1.1 billion, (ii) a “Term Loan B Facility” of \$825 million and (iii) a “Revolving Credit Facility” of \$250 million. The Term Loan A Facility and the Revolving Credit Facility have terms of five years. The Term Loan B Facility has a term of seven years. Interest rates on borrowings under the senior credit facilities are set forth in the table below. As of September 30, 2013, ARRIS had no amounts drawn under the Revolving Credit Facility.

	<u>Rate</u>	<u>As of September 30, 2013</u>
Term Loan A	LIBOR + 2.25 %	2.43%
Term Loan B	LIBOR ⁽¹⁾ + 2.75 %	3.50%
Revolving Credit Facility ⁽²⁾	LIBOR + 2.25 %	Not Applicable

(1) Includes LIBOR floor of 0.75%

(2) Includes unused commitment fee of 50 basis points not reflected in interest rate above.

Borrowings under the senior secured credit facilities are secured by first priority liens on substantially all of the assets of ARRIS and certain of its present and future subsidiaries who are or become parties to, or guarantors under, the credit agreement governing the senior secured credit facilities (the “Credit Agreement”). The Credit Agreement contains usual and customary limitations on indebtedness, liens, restricted payments, acquisitions and asset sales in the form of affirmative, negative and financial covenants, which are customary for financings of this type, including the maintenance of a minimum consolidated interest coverage ratio of not less than 3.5:1 and a maximum consolidated net leverage ratio of 4.25:1 (which decreases to 3.5:1 throughout the first two years of the Credit Agreement). As of September 30, 2013, ARRIS was in compliance with all covenants under the Credit Agreement.

The Credit Agreement provides terms for mandatory prepayments and optional prepayments and commitment reductions. The Credit Agreement also includes events of default, which are customary for facilities of this type (with customary grace periods, as applicable), including provisions under which, upon the occurrence of an event of default, all amounts outstanding under the credit facilities may be accelerated.

The Credit Agreement also provides that ARRIS should hold Unrestricted Cash in an amount at least equal to the aggregate principal amount outstanding under the Convertible Notes at such time. The Unrestricted Cash balance recorded in the Company’s Consolidated Balance Sheet as of September 30, 2013 was in excess of the principal amount outstanding under the Convertible Notes.

During the three and nine months ended September 30, 2013, the Company made mandatory prepayments related to the senior secured credit facilities of approximately \$15.8 million and \$31.6 million, respectively. As of September 30, 2013, the balance for the senior secured credit facilities was \$1,893.4 million.

Note 15. Supplemental Financial Information*Consolidated Balance Sheets Information*

Other current assets consist of the following (in thousands):

	<u>September 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Miscellaneous receivables	\$ 1,977	\$ 3,652
Deferred cost of sales	12,687	9,537
Sales and other tax receivables	13,437	1,565
Deferred financing fees	8,012	559
Dividend receivable – equity investment	14,568	–
Landlord funded tenant improvements	1,450	–
Other	8,040	1,100
Total	<u>\$ 60,171</u>	<u>\$ 16,413</u>

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Other non-current assets consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Deferred financing fees	\$ 30,749	\$ 400
Trade receivables	9,025	–
Deposits	2,854	1,204
Long-term severance funds	3,512	3,739
Other	6,160	4,042
Total	<u>\$ 52,300</u>	<u>\$ 9,385</u>

Other accrued current liabilities consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Accrued restructuring	\$ 8,513	\$ 527
Accrued volume rebates	31,670	3,434
Accrued royalties	3,805	1,253
Accrued sales, property and other taxes	15,706	1,534
Accrued interest and interest rate swap liability	11,370	581
Google (net cash payments made on our behalf)	16,253	–
Supplier liabilities	12,847	–
Accrued software licenses liabilities	5,881	–
Accrued acquisition costs	1,423	4,361
Accrued legal and professional fees	5,052	4,277
Accrued freight	1,782	1,778
Other liabilities	32,893	7,197
Total	<u>\$ 147,195</u>	<u>\$ 24,942</u>

Other noncurrent liabilities consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Long-term deferred revenue	\$ 4,908	\$ 4,288
Long-term warranty	29,619	3,187
Long-term severance liability	3,870	4,119
Deferred compensation liabilities	7,049	6,668
Long-term accrued rent	1,476	1,413
Long-term tenant improvement obligations	1,086	1,140
Other	9,327	2,347
Total	<u>\$ 57,335</u>	<u>\$ 23,162</u>

Note 16. Segment Information

The “management approach” has been used to present the following segment information. This approach is based upon the way the management of the Company organizes segments within an enterprise for making operating decisions and assessing performance. Financial information is reported on the basis that it is used internally by the chief operating decision maker (“CODM”) for evaluating segment performance and deciding how to allocate resources to segments. The Company’s chief executive officer has been identified as the CODM.

Prior to the second quarter of 2013, the CODM managed the operating results of the Company as three segments, including Broadband Communications Systems (“BCS”), Access, Transport and Supplies (“ATS”) and Media & Communications Systems (“MCS”). In connection with the Acquisition, the Company changed its operating segments to align with how the CODM expected to evaluate financial information used to allocate resources and assess performance of the Company. As a result, the segment information presented in these financial statements has been conformed to present segments on this revised basis for all prior periods. Under the new organizational structure, the CODM manages the Company under two segments:

- **Customer Premises Equipment (“CPE”)** – The CPE segment’s product solutions include set-top boxes, gateways, and Subscriber Premises equipment that enable service providers to offer Voice, Video and high-speed data services to residential and business subscribers.
- **Network and Cloud (“N&C”)** – The N&C segment’s product lines cover all components required by facility-based Service Providers to construct a state-of-the-art residential and metro distribution network. For Cable providers this includes Hybrid Fiber Coax (“HFC”) equipment, edge routers, metro WiFi, video management, storage, and distribution equipment. For Telco providers this includes fiber-based and copper-based broadband transmission equipment. In addition, the portfolio includes an advanced video headend management system for both legacy MPEG/DVB systems as well as full IP Video systems. Finally, the portfolio also includes full support for advanced multi-screen video management, protection, monetization and delivery, and a suite of products for performance management, configuration, and surveillance.

These operating segments were determined based on the nature of the products and services offered. The measures that are used to assess the reportable segment’s operating performance are sales and direct contribution. A measure of assets is not applicable, as segment assets are not regularly reviewed by the CODM for evaluating performance or allocating resources.

In addition, in conjunction with changing operating segments, the Company has changed its measure of assessing segment’s operating performance from gross margin to direct contribution, which is defined as gross margin less direct operating expense. Corporate and other expenses, such as selling and central G&A, not included in the measure of segment direct contribution are reported in “Other” and are reconciled to income (loss) before income taxes. As a result, the segment information presented in these financial statements has been conformed to present the Company’s segments on this revised basis for all prior periods presented.

The table below represents information about the Company’s reporting segments for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Reportable Segments				Other		Consolidated	
	Network & Cloud		CPE		2013	2012	2013	2012
	2013	2012	2013	2012				
For the three months ended September 30,								
Sales	\$ 320,484	\$ 174,858	\$ 748,895	\$ 182,574	\$ (1,556)	–	\$ 1,067,823	\$ 357,432
Direct Contribution	59,566	44,857	150,383	25,017	(121,093)	(38,766)	88,856	31,108
Restructuring charges					6,057	213	6,057	213
Acquisition & other costs					6,221	30	6,221	30
Amortization of intangible assets					64,606	7,742	64,606	7,742
Operating income							11,972	23,123
Other expense							22,029	2,277
Income (loss) before income taxes							\$ (10,057)	\$ 20,846

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For the nine months ended September 30,	Reportable Segments						Consolidated	
	Network & Cloud		CPE		Other		2013	2012
	2013	2012	2013	2012	2013	2012		
Sales	\$837,731	\$560,056	\$1,601,259	\$449,604	\$ (17,155)	–	\$2,421,835	\$1,009,660
Direct Contribution	183,220	167,638	295,018	45,369	(345,162)	(121,171)	133,076	91,836
Restructuring charges					38,323	6,455	38,323	6,455
Acquisition & other costs					32,803	1,076	32,803	1,076
Amortization of intangible assets					127,751	22,565	127,751	22,565
Operating income (loss)							(65,801)	61,740
Other expense							55,208	9,646
Income (loss) before income taxes							\$ (121,009)	\$ 52,094

Note 17. Sales Information

The Company's three largest customers (including their affiliates, as applicable) are Comcast, Time Warner Cable and Verizon. Over the past year, certain customers' beneficial ownership may have changed as a result of mergers and acquisitions. Therefore the revenue for ARRIS' customers for prior periods has been adjusted to include their affiliates under common control. A summary of sales to these customers for the three and nine months ended September 30, 2013 and 2012 are set forth below (in thousands): The significant changes in the percentages of the total sales primarily result from the greater customer diversification as a result of the Acquisition.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Comcast and affiliates	\$ 204,039	\$ 117,557	\$452,285	\$295,207
% of sales	19.1%	32.9%	18.7%	29.2%
Time Warner Cable and affiliates	\$ 85,569	\$ 68,966	\$ 276,841	\$ 191,388
% of sales	8.0%	19.3%	11.4%	19.0%
Verizon and affiliates	\$ 118,220	–	\$ 208,612	–
% of sales	11.1%	–	8.6%	–

ARRIS sells its products primarily in the United States. The Company's international revenue is generated from Asia Pacific, Canada, Europe, and Latin America. For the three months ended September 30, 2013 and 2012, sales to international customers were approximately 31.5% and 22.0%, respectively, of total sales. For the nine months ended September 30, 2013 and 2012, sales to international customers were 32.7% and 24.3%, respectively, of total sales.

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International sales by region for the three and nine months ended September 30, 2013 and 2012 were as follows (in thousands):

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Americas, excluding U.S. ⁽¹⁾	\$ 217,843	\$ 44,418	\$ 501,052	\$ 148,245
Asia Pacific	48,869	21,194	108,102	45,942
EMEA	69,673	13,106	181,598	51,481
Total international sales	<u>\$336,385</u>	<u>\$78,718</u>	<u>\$790,752</u>	<u>\$245,668</u>

(1) Excludes U.S. sales of \$731.4 million and \$1,631.0 million for the three and nine months ended September 30, 2013, respectively. Excludes U.S. sales of \$278.7 million and \$764.0 million for the three and nine months ended September 30, 2012, respectively.

Note 18. Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share (“EPS”) computations for the periods indicated (in thousands except per share data):

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Basic:				
Net (loss) income	<u>\$ 17,959</u>	<u>\$ 17,864</u>	<u>\$ (44,380)</u>	<u>\$ 38,664</u>
Weighted average shares outstanding	<u>138,478</u>	<u>113,709</u>	<u>129,502</u>	<u>114,206</u>
Basic (loss) earnings per share	<u>\$ 0.13</u>	<u>\$ 0.16</u>	<u>\$ (0.34)</u>	<u>\$ 0.34</u>
Diluted:				
Net (loss) income	<u>\$ 17,959</u>	<u>\$ 17,864</u>	<u>\$ (44,380)</u>	<u>\$ 38,664</u>
Weighted average shares outstanding	<u>138,478</u>	<u>113,709</u>	<u>129,502</u>	<u>114,206</u>
Net effect of dilutive equity awards	<u>2,127</u>	<u>2,637</u>	<u>—</u>	<u>2,142</u>
Total	<u>140,605</u>	<u>116,346</u>	<u>129,502</u>	<u>116,348</u>
Diluted (loss) earnings per share	<u>\$ 0.13</u>	<u>\$ 0.15</u>	<u>\$ (0.34)</u>	<u>\$ 0.33</u>

As discussed in Note 14 *Long-Term Indebtedness*, in November 2006, the Company issued \$276.0 million of convertible senior notes. Upon conversion, ARRIS is required to satisfy the primary component of the conversion consideration in cash, rather than common stock. The secondary component of the conversion consideration, which is only paid if the trading price of the Company’s common stock is above the conversion price specified in the indenture, is comprised of cash, shares of the Company’s common stock or a combination of both, at the Company’s election. Thus, the potential earnings dilution only relates to the secondary component. The average share price during the three and nine months ended September 30, 2013 and 2012 was less than the conversion price, and consequently, did not result in dilution. However, basic shares were used for the nine months ended September 30, 2013 as a net loss was reported for the quarter and the inclusion of dilutive shares would be antidilutive.

For the three and nine months ended September 30, 2013, approximately 2.8 million and 1.4 million of the equity-based awards, respectively, were excluded from the computation of diluted earnings per share shares because their effect would have been anti-dilutive. For the three months ended September 30, 2012, all outstanding equity-based

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awards were dilutive. For the nine months ended September 30, 2012, approximately 2.2 million of the equity-based awards were excluded from the dilutive securities above. These exclusions are made if the exercise price of these equity-based awards is in excess of the average market price of the common stock for the period, or if the Company has net losses, both of which have an anti-dilutive effect.

During the nine months ended September 30, 2013, the Company issued 2.8 million shares of its common stock related to stock option exercises and the vesting of restricted shares, as compared to 1.7 million shares for the twelve months ended December 31, 2012.

In connection with the Acquisition, the Seller was issued approximately 10.6 million shares of ARRIS' common stock as part of the purchase consideration. The fair value of the 10.6 million shares issued, \$150 million, was determined based on the 20 trading day trailing average closing price of the Company's common stock at signing of the definitive agreement. Furthermore, Comcast was given an opportunity to invest in ARRIS, and on January 11, 2013, the Company entered into a separate agreement accounted for as a contingent equity forward with a subsidiary of Comcast providing for the purchase by it from the Company of approximately 10.6 million shares of common stock for \$150 million. As a result of the sale of common stock to Comcast, both Comcast and Google each own approximately 7.7% of the outstanding ARRIS shares post-closing based on ARRIS' current capitalization. The Comcast transaction was consummated on the same day as the Acquisition. (See Note 3 *Business Acquisitions* and Note 5 *Comcast Investment in ARRIS* for additional details)

Note 19. Income Taxes

For the nine month periods ended September 30, 2013 and 2012, the Company recorded income tax expense (benefit) of \$(76.6) million and \$13.4 million, respectively. Below is a summary of the components of the tax expense (benefit) for the three and nine month periods ended September 30, 2013 and 2012 (in thousands, except for percentages):

	Three Months Ended September 30,					
	2013			2012		
	(Loss) Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate	Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate
Non-discrete items	\$ 9,481	\$ (14,547)	(120.5)%	\$ 20,846	\$ 7,165	34.4%
Discrete events						
Acquisition-related costs	(12,277)	(3,818)		—	—	
Return to provision adjustments	—	(2,052)		—	(841)	
Loss from certain foreign entities acquired	(7,261)	—		—	—	
Valuation allowances, uncertain tax position	—	(7,599)		—	(3,342)	
Total	\$ (10,057)	\$ (28,016)	375.1%	\$ 20,846	\$ 2,982	14.3%
	Nine Months Ended September 30,					
	2013			2012		
	(Loss) Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate	Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate
Non-discrete items	\$ (11,957)	\$ (38,735)	324.0%	\$ 52,094	\$ 17,613	33.8%
Discrete events						
Acquisition-related costs	(71,126)	(23,568)		—	—	
Return to provision adjustments (including R&D credits)	—	(8,552)		—	—	
Comcast's investment in ARRIS	(26,371)	—		—	(841)	
Loss from certain foreign entities acquired	(11,555)	—		—	—	
Valuation allowances, uncertain tax position	—	(5,774)		—	(3,342)	
Total	\$ (121,009)	\$ (76,629)	63.3%	\$ 52,094	\$ 13,430	25.8%

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- The reduction in the income tax expense (benefit) for the three and nine month periods ended September 30, 2013, compared to the three and nine months ended September 30, 2012, was due to the change in earnings from continuing operations, as a result of the Acquisition that occurred on April 17, 2013 and its related significant, infrequent and unusual book charges. In addition, there were significant and unusual tax charges relating to 2012 return to provision changes and releases of uncertain tax positions, due to expirations of periods during which certain returns could be audited by the applicable taxing authorities.
- For the nine month periods ended September 30, 2013 and 2012, our estimated effective tax rates were 63.3% and 25.8%, respectively. The rate of 63.3% is based on the Company's pre-tax book loss of approximately \$(121.0) million and a tax benefit of approximately \$(76.6) million, for the nine month period ended September 30, 2013. The change in the estimated effective tax rate for the nine month periods ended September 30, 2013, compared to the nine months ended September 30, 2012, was due to a benefit from the research and development tax credit legislation reenacted retroactively to January 2012, which is included in the return to provision adjustments. Further benefits arose from the release of uncertain tax liabilities, as well as significant, unusual and infrequent book charges related to the Acquisition.
- For the nine month period ended September 30, 2013, the Company recorded a benefit of approximately \$(5.9) million related to 2012 research and development tax credits. The U.S. research and development credit was reenacted in January 2013 retroactive to the beginning of 2012. The full year 2012 impact of the research and development tax credits was recognized in the three month period ended March 31, 2013. That amount was trued-up with a provision to return adjustment of approximately \$(1) million. For the nine month period ended September 30, 2012, the Company did not record any benefits attributed to research and development tax credits, as the tax credit was not reenacted until January 2013.
- For the nine month period ended September 30, 2013, the Company recorded additional benefits of \$(2.7) million and \$(5.8) million from return to provision adjustments and releases of uncertain tax liabilities due to expiration of periods during which certain returns could be audited by applicable taxing authorities, respectively.
- For the nine month period ended September 30, 2013, the Company recorded significant book expenses of an infrequent and unusual nature of approximately \$(71.1) million relating to the Acquisition, generating a tax benefit of \$(23.6) million. These unusual expenses include the restructuring charges that were identified and arose from the synergy and integration plans of the Company. Additionally, for the nine month period ended September 30, 2013, the Company recorded a pre-tax book loss of approximately \$(26.4) million on the investment in the Company by Comcast and a pre-tax book loss of approximately \$(11.6) million on certain foreign entities from Acquisition, on which no tax benefit was recorded.
- For the nine month period ended September 30, 2012, the Company recorded a benefit of \$(4.2) million from the release of liabilities related to uncertain tax positions and return to provision adjustments.

The earnings from the Company's non-U.S. subsidiaries are considered to be permanently invested outside of the United States. Accordingly, no provision for U.S. federal and state income taxes on those non-U.S. earnings has been made in the accompanying consolidated financial statements. Any future distribution of these non-U.S. earnings may subject the Company to both U.S. federal and state income taxes, after reduction for foreign taxes credited.

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Note 20. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component, net of taxes, for the nine months ended September 30, 2013 (in thousands):

	<u>Unrealized gain on marketable securities</u>	<u>Unrealized loss on derivative instruments</u>	<u>Unfunded pension liability</u>	<u>Cumulative translation adjustments</u>	<u>Total</u>
Balance as of December 31, 2012	\$ 206	\$ -	\$(8,558)	\$ (184)	\$ (8,536)
Other comprehensive (loss) income before reclassifications	(205)	(5,530)	-	156	(5,579)
Amounts reclassified from accumulated other comprehensive income (loss)	84	1,253	-	-	1,337
Net current-period other comprehensive income (loss)	(121)	(4,277)	-	156	(4,242)
Balance as of September 30, 2013	<u>\$ 85</u>	<u>\$ (4,277)</u>	<u>\$(8,558)</u>	<u>\$ (28)</u>	<u>\$(12,778)</u>

Note 21. Commitments

ARRIS leases office, distribution, and warehouse facilities as well as equipment under long-term leases expiring at various dates through 2023. Included in these operating leases are certain amounts related to restructuring activities; these lease payments and related sublease income are included in restructuring accruals on the consolidated balance sheets. Future minimum operating lease payments under non-cancelable leases at September 30, 2013 were as follows (in thousands):

	<u>Operating Leases</u>
2013 (remaining three months)	\$ 6,229
2014	20,934
2015	16,365
2016	12,894
2017	8,903
2018	5,513
Thereafter	4,542
Less sublease income	(6,801)
Total minimum lease payments	<u>\$ 68,579</u>

Total rental expense for all operating leases amounted to approximately \$15.4 million and \$12.4 million for the nine months ended September 30, 2013 and twelve months ended December 31, 2012, respectively.

As of September 30, 2013, the Company had approximately \$1.8 million of restricted cash. The restricted cash balances are held as cash collateral security for certain letters of credit and bank guarantees. Additionally, the Company had contractual obligations of approximately \$585.6 million under agreements with non-cancelable terms to purchase goods or services over the next year. All contractual obligations outstanding at the end of prior years were satisfied within a 12 month period, and the obligations outstanding as of September 30, 2013 are expected to be satisfied in 2014.

Note 22. Contingencies

The Company accrues a liability for legal contingencies when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The Company reviews these accruals and adjusts them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and the Company's views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in the Company's accrued liabilities would be recorded in the period in which such determinations are made. Unless noted otherwise, the amount of liability is not probable or the amount cannot be reasonably estimated; and, therefore, accruals have not been made.

Due to the nature of the Company's business, it is subject to patent infringement claims, including current suits against it or one or more of its wholly-owned subsidiaries, or one or more of our customers who may seek indemnification from us, alleging infringement by various Company products and services. The Company believes that it has meritorious defenses to the allegation made in its pending cases and intends to vigorously defend these lawsuits; however, it is currently unable to determine the ultimate outcome of these or similar matters. Accordingly, with respect to these proceedings, we are currently unable to reasonably estimate the possible loss or range of possible losses. In addition, the Company is a defendant in various litigation matters generally arising out of the normal course of business.

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As part of the Acquisition, a subsidiary of Google Inc., has agreed to indemnify the Company for any losses suffered by the Company related to certain specified retained litigation matters, subject to the Company being responsible for 50% of the first \$50 million in respect of past infringement and 50% of the first \$50 million in respect of certain future royalty payments related to the specified retained litigation matters, for a total obligation of \$50 million.

During the third quarter ended September 30, 2013, the Company settled certain of these specified retained litigation matters as follows:

TiVo

The Company, Google, Inc. and TiVo settled all claims associated with certain patent infringement litigation for \$196 million, which included non-exclusive, worldwide, non-transferable and perpetual license to the patents subject to the litigation. On the date the Settlement Agreement and Release was executed, the Company was legally responsible to TiVo for the liability arising from the litigation, if any. Payment was made in the quarter ended September 30, 2013. Google indemnified the Company for the amount of the payment except for \$50 million for which the Company is responsible as described above.

Verizon

The Company, Google, Inc. and Verizon Sourcing LLC reached a settlement agreement, whereby the Company paid \$85 million to Verizon to settle patent infringement litigation in the quarter ended September 30, 2013. In consideration for this cash payment, the Company will have no further obligation for any indemnification of any claim arising from the Verizon claim. Google indemnified the Company for the full amount of the Company's payment.

Note 23. Subsequent Events

On October 17, 2013, the Company announced that it would redeem the Notes (See Note 14. *Long-Term Indebtedness* for additional details) for par value on November 15, 2013. On October 15, 2013 the Company also announced that the Notes are convertible at the option of the holders from October 15, 2013 until 11:59 p.m. E.T. on November 15, 2013 for the consideration specified in the indenture (the "Conversion Option"). The Company also announced October 17, 2013 holders of the Notes have an option to require the Company to purchase the Notes for par value on November 15, 2013 (the "Put Option"). None of the Company, its Board of Directors, or its employees or the Trustee has made or is making any representation or recommendation to any holder of Notes as to whether to exercise or refrain from exercising the Conversion Option, the Put Option or Repurchase Option. Any Notes not surrendered pursuant to the Put Option of the Conversion Option will be redeemed on November 15, 2013.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a premier video and broadband technology company that transforms how service providers worldwide deliver entertainment and communications without boundaries. Our powerful end-to-end platforms enable service and content providers to improve the way people connect with each other and with their favorite content. Headquartered north of Atlanta, in Suwanee, Georgia, we have R&D, sales and support centers throughout the world.

Acquisition of Motorola Home

On April 17, 2013 we acquired the Motorola Home business from General Instrument Holdings, Inc., a subsidiary of Google, Inc. for \$2.4 billion in cash and equity, subject to certain adjustments as provided for in the acquisition agreement (the "Acquisition"). We believe the Acquisition enhances our ability to provide next-generation consumer video products and services, supporting a more comprehensive product offering while also accelerating our ability to deliver a comprehensive set of industry-leading new products to a wide spectrum of customers. We more than doubled in size as a result of the Acquisition, which had significant effects on virtually every aspect of our business and operations and which make comparisons in this discussion to our historical results difficult. These impacts include:

- *Significant Increase in Scale and Geographic Footprint.* Our sales increased from \$353.7 million for the first quarter 2013 to \$1,067.8 million for the third quarter of 2013, compared to \$302.9 million and \$357.4 million, respectively for the same periods in 2012. We almost tripled our number of employees from approximately 2,200 employees to approximately 6,500 employees. In addition, we now have a direct presence in over 25 countries and channel presence in over 85 countries compared to 21 and 30, respectively, prior to the Acquisition.
- *Expansion of the Industry that we Serve.* Historically almost all of our revenues were derived from sales to cable television multiple system operators ("MSOs"). While MSOs remain a large and important component of our business, our operations have broadened through the Acquisition to include more sales to telephone companies and programmers, as well as the addition of retail distribution channels. As a result, we have a significantly more diverse customer base. Our top five customers following the Acquisition would have accounted for approximately 50% of our 2012 sales on a pro forma basis, compared with over 50% from only our two largest customers, Comcast and Time Warner, prior to the Acquisition.
- *Additional Product Offerings.* Our portfolio of products expanded as a result of the Acquisition to include products for passive optical networks, optical Ethernet components, multiscreen software solutions and DSL modems and gateways. In addition, our traditional product lines, such as set-top boxes and gateways, routers, DOCSIS cable modems, encoders and transcoders, have expanded, in many cases, increasing our relevance with our customers.
- *Increased IP Portfolio and R&D.* We now have over 2,000 granted and in-process patents, which is more than double our portfolio prior to the Acquisition. In addition, as part of the transaction we also received a limited license to approximately 20,000 additional patents. With the additional resources and employees gained from the Acquisition, we expect to significantly increase our investment in fundamental research, expanding our intellectual property rights and developing new product offerings.
- *Debt.* As described below under "Financial Liquidity and Capital Resources," we entered into senior secured credit facilities to fund a portion of the acquisition costs and to support our on-going working capital needs. As a result, the face value our debt increased from \$232.1 million at March 31, 2013 to \$2,125.3 million at September 30, 2013. We are subject to a number of financial covenants under the senior secured credit facilities that could impact our operational flexibility.

In addition, as described below, we have reduced our reportable operating segments from three to two. Readers should consider the size and transformative nature of the Acquisition when reviewing this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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New Operating Segments

The completion of the Motorola Home acquisition changed the way that we manage and review our business. As a result, beginning with the periods ended June 30, 2013, we now report two operating segments, (1) Network & Cloud and (2) Customer Premises Equipment. Corporate and other expenses not included in the measure of segment contribution will be reported in an “All Other” category. A comparison of our products and the acquired Motorola Home products included in our new reporting segments is set forth in the table below. See Note 16 for additional information regarding this resegmentation.

<u>ARRIS</u>	<i>Prior Segments</i>	<u>Motorola Home</u>	<i>New Segments</i>
<i>Broadband Communications Systems:</i> <ul style="list-style-type: none">• CMTS, CCAP, Edge QAMs, Encoder/Decoder/Transcoder	<i>Network Infrastructure:</i> <ul style="list-style-type: none">• CMTS, Edge QAMs, HE Optics, Fiber Nodes, RF Amplifiers, Encoders/Decoders/Transcoders		<i>Network and Cloud (“N&C”)</i>
<i>Access, Transport & Supplies:</i> <ul style="list-style-type: none">• HE Optics, Fiber Nodes & RF Amplifiers	<i>Convergence Experiences:</i> <ul style="list-style-type: none">• Service Assurance, Content Management & Security, Ad Insertion, Video on Demand, User Experience		
<i>Media & Communication Systems:</i> <ul style="list-style-type: none">• Service Assurance, Analytics, Workforce Management, Video on Demand, Ad Insertion & Management			
<i>Broadband Communications Systems:</i> <ul style="list-style-type: none">• Modems, EMTAs, Gateways	<i>Home Devices:</i> <ul style="list-style-type: none">• Modems, EMTAs, Gateways, Set-top Boxes		<i>Customer Premises Equipment (“CPE”)</i>

Key Highlights

Set forth below are some key highlights that we achieved in the three and nine months ended September 30, 2013:

Financial Highlights

- Sales in the third quarter and nine months ended September 30, 2013 were \$1,067.8 million and \$2,421.8 million, respectively, as compared to \$357.5 million and \$1,009.7 million in the same periods in 2012. The increase is primarily attributed to the inclusion of sales from the acquired Motorola Home business.
- Gross margin percentage was 29.7% in the third quarter of 2013, which compares to 31.3% in the third quarter of 2012. The year over year decline reflects the inclusion of the Motorola Home products, which in the aggregate have lower overall margins than the historic ARRIS products.
- Total operating expenses (excluding amortization of intangible assets, restructuring charges and acquisition and other costs) in the third quarter of 2013 were \$228.1 million, as compared to \$80.9 million in the same period last year. The increase is the result of the inclusion of expenses associated with the Acquisition.
- We incurred \$6.1 million of restructuring charges and \$6.2 million of acquisition and integration related costs in the third quarter 2013 related to the Acquisition.
- Intangible amortization increased from \$7.7 million in the third quarter 2012 to \$64.6 million in the third quarter 2013 as a result of the Acquisition.
- We ended the third quarter of 2013 with \$695.0 million of cash, cash equivalents, short-term and long-term marketable security investments. The Company generated \$380.0 million of cash from operating activities through the first nine months of 2013, which compares to \$72.6 million generated during the same period

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in 2012. The portion of earnings that are cash-based were approximately \$135.8 million during the same period. Changes in working capital, primarily accounts payable, accrued liabilities and inventory, accounted for \$244.3 million of the change in cash from operating activities through the first nine months of 2013.

- We ended the third quarter 2013 with outstanding debt of \$2,116.3 million, the current portion of which is \$293.4 million. We anticipate retiring the short-term debt with cash resources. We issued \$1,925 million of new debt in the second quarter 2013 in conjunction with our acquisition of Motorola Home.

Product Line Highlights

- Customer Premises Equipment
 - o Set-top Solutions
 - i Continue to experience strong customer interest around new in-home architectures and technologies for delivering the latest in video and broadband-based services.
 - i Achieved product acceptance and began deployment of a new set top box platform for Charter Communications.
 - i Commenced XG1 video gateway field trials with Comcast as part of the ongoing ARRIS product qualification activity.
 - i Announced a new portfolio of devices, including wireless set-tops, at the IBC2013 (International Broadcasting Convention) trade show.
 - i Selected by Telenor Sweden to provide IPTV set top box solutions.
 - o Broadband Devices
 - i DOCSIS device shipments remained solid in the third quarter as consumer demand for broadband services continued. Approximately 89 percent of the third quarter 2013 DOCSIS devices shipments were DOCSIS 3.0 capable units and 60 percent of the shipments included WiFi enabled product.
 - i Introduced a next generation wireless data gateway into the retail channel that included support for IEEE 802.11AC.
- Network and Cloud
 - o CMTS
 - i Continued deployment of E6000 Converged Edge Router, approaching 1 million in service subscribers connected to the platform.
 - i Continued deployment of both C4 and BSR CMTS platforms as operators continue to cost effectively extend their current installed base, although operator capital expenditure, are shifting to new E6000 Converged Cable Access Platform.
 - o Access and Transport
 - i Momentum building around deep fiber and all-digital optics network architectures.
 - o Video Infrastructure
 - i Strong shipments of Video Processing products such as the Cherry Picker Application Platform CAP-1000 as operators continue to invest in improving the reliability and flexibility of their video distribution network.
 - i Several new APEX3000 EdgeQAM customer wins.
 - i Announced new High Efficiency Video Codec (HEVC) encoder platform.
 - i Continuing field trial of Network DVR storage and control plane with Tier 1 cable operator.
 - i Continued shipments of MPEG4 encoder/Transcoder products to programmer and IPTV operators
 - o Cloud
 - i Good growth in both Dream Gallery and Moxi subscriber base
 - i Announced partnership with Echostar and their Sling product team to integrate their place-shifting technology with the ARRIS Mobile TV products

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Non-GAAP Measures

As part of our ongoing review of financial information related to our business, we regularly use non-GAAP measures, in particular non-GAAP net income per share, as we believe they provide a meaningful insight into our business and trends. We also believe that these non-GAAP measures provide readers of our financial statements with useful information and insight with respect to the results of our business. However, the presentation of non-GAAP information is not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. Below are tables for the three and nine months ended September 30, 2013 and 2012 which detail and reconcile GAAP and non-GAAP net income per share:

(in thousands, except per share data)

	For the Three Months Ended September 30, 2013						
	<u>Sales</u>	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Amounts in accordance with GAAP	\$ 1,067,823	\$ 316,992	\$ 305,020	\$ 11,972	\$ 22,029	\$ (28,016)	\$ 17,959
Acquisition accounting impacts related to deferred revenue	1,556	1,006	-	1,006	-	-	1,006
Stock compensation expense	-	1,248	(9,481)	10,729	-	-	10,729
Amortization of intangible assets	-	-	(64,606)	64,606	-	-	64,606
Acquisition costs, restructuring, and integration costs	-	-	(12,278)	12,278	-	-	12,278
Non-cash interest expense	-	-	-	-	(3,374)	-	3,374
Net tax items	-	-	-	-	-	54,998	(54,998)
Non-GAAP amounts	<u>\$ 1,069,379</u>	<u>\$ 319,246</u>	<u>\$ 218,655</u>	<u>\$ 100,591</u>	<u>\$ 18,655</u>	<u>\$ 26,982</u>	<u>\$ 54,954</u>
GAAP net income per share - diluted							<u>\$ 0.13</u>
Non-GAAP net income per share - diluted							<u>\$ 0.39</u>
Weighted average common shares - basic							<u>138,478</u>
Weighted average common shares - diluted							<u>140,605</u>

(in thousands, except per share data)

	For the Nine Months Ended September 30, 2013						
	<u>Sales</u>	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Amounts in accordance with GAAP	\$ 2,421,835	\$ 656,595	\$ 722,396	\$ (65,801)	\$ 55,208	\$ (76,629)	\$ (44,380)
Reduction in revenue related to Comcast's investment in ARRIS	13,182	13,182	-	13,182	-	-	13,182
Acquisition accounting impacts related to fair value of inventory	-	57,600	-	57,600	-	-	57,600
Acquisition accounting impacts related to deferred revenue	3,973	2,478	-	2,478	-	-	2,478
Product Rationalization	-	13,582	-	13,582	-	-	13,582
Stock compensation expense	-	2,945	(21,708)	24,653	-	-	24,653
Amortization of intangible assets	-	-	(127,751)	127,751	-	-	127,751
Acquisition costs, restructuring, and integration costs	-	-	(71,127)	71,127	-	-	71,127
Credit facility - ticking fees	-	-	-	-	(865)	-	865
Mark-to-market FV adjustment related to Comcast's investment in ARRIS	-	-	-	-	(13,189)	-	13,189
Non-cash interest expense	-	-	-	-	(9,926)	-	9,926
Net tax items	-	-	-	-	-	143,034	(143,034)
Non-GAAP amounts	<u>\$ 2,438,990</u>	<u>\$ 746,382</u>	<u>\$ 501,810</u>	<u>\$ 244,572</u>	<u>\$ 31,228</u>	<u>\$ 66,405</u>	<u>\$ 146,939</u>
GAAP net loss per share - diluted							<u>\$ (0.34)</u>
Non-GAAP net income per share - diluted							<u>\$ 1.11</u>
Weighted average common shares - basic							<u>129,502</u>
Weighted average common shares - diluted							<u>132,169</u>

(1) Basic shares used as losses were reported for those periods and the inclusion of dilutive shares would be anti-dilutive

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(in thousands, except per share data)

For the Three Months Ended September 30, 2012							
	<u>Sales</u>	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Amounts in accordance with GAAP	\$ 357,432	\$111,952	\$ 88,829	\$ 23,123	\$ 2,277	\$ 2,982	\$ 17,864
Acquisition accounting impacts of deferred revenue	546	546	-	546	-	-	546
Stock compensation expense	-	808	(5,870)	6,678	-	-	6,678
Amortization of intangible assets	-	-	(7,742)	7,742	-	-	7,742
Acquisition costs	-	-	(30)	30	-	-	30
Restructuring	-	-	(213)	213	-	-	213
Non-cash interest expense	-	-	-	-	(3,120)	-	3,120
Net tax items	-	-	-	-	-	10,545	(10,545)
Non-GAAP amounts	<u>\$ 357,978</u>	<u>\$ 113,306</u>	<u>\$ 74,974</u>	<u>\$ 38,332</u>	<u>\$ (843)</u>	<u>\$ 13,527</u>	<u>\$ 25,648</u>
GAAP net income per share - diluted							<u>\$ 0.15</u>
Non-GAAP net income per share - diluted							<u>\$ 0.22</u>
Weighted average common shares - basic							<u>113,709</u>
Weighted average common shares - diluted							<u>116,346</u>

(in thousands, except per share data)

For the Nine Months Ended September 30, 2012							
	<u>Sales</u>	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Amounts in accordance with GAAP	\$ 1,009,660	\$339,386	\$ 277,646	\$ 61,740	\$ 9,646	\$ 13,430	\$ 38,664
Acquisition accounting impacts of deferred revenue	2,980	2,467	-	2,467	-	-	2,467
Stock compensation expense	-	2,367	(18,827)	21,194	-	-	21,194
Amortization of intangible assets	-	-	(22,565)	22,565	-	-	22,565
Acquisition costs	-	-	(739)	739	-	-	739
Restructuring	-	-	(6,455)	6,455	-	-	6,455
Loss of sale of product line	-	-	(337)	337	-	-	337
Impairment of investment	-	-	(466)	466	-	-	466
Non-cash interest expense	-	-	-	-	(9,177)	-	9,177
Net tax items	-	-	-	-	-	25,415	(25,415)
Non-GAAP amounts	<u>\$1,012,640</u>	<u>\$344,220</u>	<u>\$228,257</u>	<u>\$ 115,963</u>	<u>\$ 469</u>	<u>\$ 38,845</u>	<u>\$ 76,649</u>
GAAP net income per share - diluted							<u>\$ 0.33</u>
Non-GAAP net income per share - diluted							<u>\$ 0.66</u>
Weighted average common shares - basic							<u>113,709</u>
Weighted average common shares - diluted							<u>116,348</u>

In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items is useful in understanding the trends and managing our operations. We provide these supplemental non-GAAP measures in order to assist the investment community to see ARRIS through the “eyes of management,” and therefore enhance understanding of ARRIS’ operating performance. Non-GAAP financial measures should be viewed in addition to, and not as an alternative to, the Company’s reported results prepared in accordance with GAAP. Our non-GAAP financial measures reflect adjustments based on the following items, as well as the related income tax effects:

Reduction in Revenue Related to Comcast’s Investment in ARRIS: In connection with the Acquisition in January 2013 Comcast agreed to invest in ARRIS. The per share purchase price, which was based on the value used to determine the number of shares issued in the Acquisition, for the investment was less than the market price on the date the agreement was executed. As a result, the accounting guidance requires that we record the implied fair value of benefit received by Comcast as a reduction in revenue. We have excluded the effect of the implied fair value in calculating our non-GAAP financial measures. We believe it is useful to understand the effects of these items on our total revenues and gross margin.

Acquisition Accounting Impacts Related to Deferred Revenue: In connection with our acquisitions, business combination rules require us to account for the fair values of deferred revenue arrangements for which acceptance has not been obtained, and post contract support in our purchase accounting. The non-GAAP adjustment to our sales and cost of sales is intended to include the full amounts of such revenues as if these purchase accounting adjustments had not been applied. We believe the adjustment to these revenues is useful as a measure of the ongoing performance of our business. We historically have experienced high renewal rates related to our support agreements and our objective is to increase the renewal rates on acquired post contract support agreements. However, we cannot be certain that our customers will renew our contracts.

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Acquisition Accounting Impacts Related to Inventory Valuation: In connection with our acquisition of Motorola Home, business combinations rules require the inventory be recorded at fair value on the opening balance sheet. This is different from historical cost. Essentially we were required to write the inventory up to end customer price less a reasonable margin as a distributor. This resulted in an increase in the value of inventory and will result in higher cost of goods sold as it is sold.

Product Rationalization: In conjunction with the integration of Motorola Home, we have identified certain product lines which overlap. In the second quarter of 2013, we made the decision to eliminate certain products. As a result, we recorded expenses related to the elimination of inventory and certain vendor liabilities. We believe it is useful to understand the effects of this item on our total cost of goods sold.

Stock-Based Compensation Expense: We have excluded the effect of stock-based compensation expenses in calculating our non-GAAP operating expenses and net income (loss) measures. Although stock-based compensation is a key incentive offered to our employees, we continue to evaluate our business performance excluding stock-based compensation expenses. We record non-cash compensation expense related to grants of options and restricted stock. Depending upon the size, timing and the terms of the grants, the non-cash compensation expense may vary significantly but will recur in future periods.

Amortization of Intangible Assets: We have excluded the effect of amortization of intangible assets in calculating our non-GAAP operating expenses and net income (loss) measures. Amortization of intangible assets is non-cash, and is inconsistent in amount and frequency and is significantly affected by the timing and size of our acquisitions. Investors should note that the use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

Restructuring, Acquisition and Integration Costs: We have excluded the effect of acquisition related and other expenses and the effect of restructuring expenses in calculating our non-GAAP operating expenses and net income measures. We will incur significant expenses in connection with our recent acquisition of Motorola Home, which we generally would not otherwise incur in the periods presented as part of our continuing operations. Acquisition related expenses consist of transaction costs, costs for transitional employees, other acquired employee related costs, and integration related outside services. Restructuring expenses consist of employee severance, closing facilities, write-off of property, plant and equipment and other exit costs. We believe it is useful to understand the effects of these items on our total operating expenses.

Credit Facility - Ticking Fees: In connection with the Acquisition, the cash portion of the consideration was in part funded through debt financing commitments. A ticking fee was a fee paid to our banks to compensate for the time lag between the commitment to make the loan and the actual funding. We have excluded the effect of the ticking fee in calculating our non-GAAP financial measures. We believe it is useful to understand the effect of these items in our other (income) expense.

Mark-To-Market Fair Value Adjustment Related To Comcast Investment in ARRIS: In connection with the Acquisition, in January 2013 Comcast agreed to invest in ARRIS. The per share purchase price for the investment, which was based on the value used to determine the number of shares issued in the Acquisition, was less than the market price on the date of agreement was executed. As a result, the accounting guidance requires we mark to market the changes in the value of the investment and flow through other (income) expense. Until the closing of the deal, changes in the value of the investment for the full quarter were marked to market and flow through other (income) expense. We have excluded the effect of the implied fair value in calculating our non-GAAP financial measures. We believe it is useful to understand the effect of these items on our total other (income) expense.

Loss on Sale of Product Line: We have excluded the effect of a loss on the sale of a product line in calculating our non-GAAP operating expenses and net income measures. We believe it is useful to understand the effects of these items on our total operating expenses.

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Impairment of Investment: We have excluded the effect of an other-than-temporary impairment of a cost method investment in calculating our non-GAAP financial measures. We believe it is useful to understand the effect of this non-cash item in our other expense (income).

Non-Cash Interest on Convertible Debt: We have excluded the effect of non-cash interest in calculating our non-GAAP operating expenses and net income (loss) measures. We record the accretion of the debt discount related to the equity component non-cash interest expense. We believe it is useful to understand the component of interest expense that will not be paid out in cash.

Income Tax Expense (Benefit): We have excluded the tax effect of the non-GAAP items mentioned above. Additionally, we have excluded the effects of certain tax adjustments related to state valuation allowances, research and development tax credits and provision to return differences.

Significant Customers

The Company's three largest customers (including their affiliates, as applicable) are Comcast, Time Warner Cable and Verizon. Over the past year, certain customers' beneficial ownership may have changed as a result of mergers and acquisitions. Therefore the revenue for ARRIS' customers for prior periods has been adjusted to include the affiliates under common control. A summary of sales to these customers for the three and nine months ended September 30, 2013 and 2012 are set forth below (in thousands). The significant changes in the percentages of the total sales primarily result from the greater customer diversification as a result of the Motorola Home acquisition.

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Comcast and affiliates	\$ 204,039	\$ 117,557	\$452,285	\$295,207
% of sales	19.1%	32.9%	18.7%	29.2%
Time Warner Cable and affiliates	\$ 85,569	\$ 68,966	\$ 276,841	\$ 191,388
% of sales	8.0%	19.3%	11.4%	19.0%
Verizon and affiliates	\$ 118,220	—	\$ 208,612	—
% of sales	11.1%	—	8.6%	—

Comparison of Operations for the Three and Nine Months Ended September 30, 2013 and 2012

Net Sales

The table below sets forth our net sales for the three and nine months ended September 30, 2013 and 2012, for each of our segments (in thousands):

	<u>Net Sales</u>				<u>Increase (Decrease) Between 2013 and 2012</u>			
	<u>For the Three Months Ended</u> <u>September 30,</u>		<u>For the Nine Months Ended</u> <u>September 30,</u>		<u>For the Three Months Ended</u> <u>September 30,</u>		<u>For the Nine Months Ended</u> <u>September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Business Segment:								
CPE	\$ 748,895	\$ 182,574	\$ 1,601,259	\$ 449,604	\$ 566,321	310.2%	\$ 1,151,655	256.1%
N&C	320,484	174,858	837,731	560,056	145,626	83.3%	277,675	49.6%
Other	(1,556)	-	(17,155)	-	(1,556)	(100.0)%	(17,155)	(100.0)%
Total sales	<u>\$ 1,067,823</u>	<u>\$ 357,432</u>	<u>\$ 2,421,835</u>	<u>\$ 1,009,660</u>	<u>\$ 710,391</u>	198.7%	<u>\$ 1,412,175</u>	139.9%

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The table below sets forth our domestic and international sales for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Net Sales				Increase (Decrease) Between 2013 and 2012			
	For the Three Months Ended		For the Nine Months Ended		For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,		September 30		September 30	
	2013	2012	2013	2012	\$	%	\$	%
Domestic	\$ 731,438	\$278,714	\$ 1,631,083	\$ 763,992	\$ 452,724	162.4%	\$ 867,091	113.5%
International								
Americas, excluding U.S.	217,843	44,418	501,052	148,245	173,425	390.4%	352,807	238.0%
Asia Pacific	48,869	21,194	108,102	45,942	27,675	130.6%	62,160	135.3%
EMEA	69,673	13,106	181,598	51,481	56,567	431.6%	130,117	252.7%
Total International	336,385	78,718	790,752	245,668	257,667	327.3%	545,084	221.9%
Total sales	\$1,067,823	\$ 357,432	\$2,421,835	\$1,009,660	\$ 710,391	66.5%	\$1,412,175	139.9%

Customer Premises Equipment Net Sales 2013 vs. 2012

During the three and nine months ended September 30, 2013, sales in our CPE segment increased by approximately 310.2% and 256.1%, respectively, as compared to the same period in 2012. The increase is primarily attributable to the inclusion of sales associated with the Acquisition in April 2013.

Network and Cloud Net Sales 2013 vs. 2012

During the three and nine months ended September 30, 2013, sales in the N&C segment increased by approximately 83.3% and 49.6%, respectively, as compared to the same period in 2012. The increase in sales is primarily the result of the inclusion of sale associated with our acquisition of Motorola Home.

Gross Margin

The table below sets forth our gross margin for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Gross Margin				Increase (Decrease) Between 2013 and 2012			
	For the Three Months Ended		For the Nine Months Ended		For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,		September 30		September 30	
	2013	2012	2013	2012	\$	%	\$	%
Gross margin dollars	\$316,992	\$111,952	\$656,595	\$339,386	\$ 205,040	183.1%	\$ 317,209	93.5%
Gross margin percentage	29.7%	31.3%	27.1%	33.6%		(1.6)		(6.5)

During the three and nine months ended September 30, 2013, gross margin dollars increased and gross margin percentage decreased as compared to the same period in 2012. Increase in gross margin dollars is primarily the result of the inclusion of sales associated with our acquisition of Motorola Home. The decrease in gross margin percentage is the result of product mix. The historic gross margin of Motorola Home products is lower than the average of the historic ARRIS business. Also leading to the mix impact is the relative proportion of legacy Motorola Home sales and ARRIS sales; legacy Motorola Home sales are significantly higher. The gross margin for the nine months ended September 30, 2013 includes a \$57.6 million impact associated with writing up the historic cost of the Motorola Home inventory to fair value at the date of acquisition (subsequently increasing cost of goods sold) as well as \$13.6 million of costs associated with the rationalization of certain products after the acquisition date. We do not expect these items to impact future quarters.

[Table of Contents](#)**Operating Expenses**

The table below provides detail regarding our operating expenses (in thousands):

	Operating Expenses				Increase (Decrease) Between 2013 and 2012			
	For the Three Months Ended		For the Nine Months Ended		For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,		September 30		September 30	
	2013	2012	2013	2012	\$	%	\$	%
SG&A	\$ 99,557	\$ 37,866	\$ 227,458	\$ 117,544	\$ 61,691	162.9%	\$ 109,914	93.5%
Research & development	128,579	42,978	296,061	130,006	85,601	199.2%	166,055	127.7%
Restructuring charges	6,057	213	38,323	6,455	5,844	2,743.7%	31,868	493.7%
Acquisition & other costs	6,221	30	32,803	1,076	6,191	20,636.7%	31,727	2,948.6%
Amortization of intangibles	64,606	7,742	127,751	22,565	56,864	734.5%	105,186	466.2%
Total	<u>\$ 305,020</u>	<u>\$ 88,829</u>	<u>\$ 722,396</u>	<u>\$ 277,646</u>	<u>\$ 216,191</u>	243.4%	<u>\$ 444,750</u>	160.2%

Selling, General, and Administrative, or SG&A, Expenses

The year over year increase in SG&A expenses primarily reflects the inclusion of expenses associated with the Motorola Home acquisition.

Research & Development, or R&D, Expenses

Included in our R&D expenses are costs directly associated with our development efforts (people, facilities, materials, etc.) and reasonable allocations of our information technology and corporate facility costs. R&D expenses for the three and nine months ended September 30, 2013 increased as compared to the same period in 2012 due to the inclusion of expenses associated with the Motorola Home acquisition.

Restructuring Charges

During the first nine months of 2013, ARRIS continued the restructuring initiative implemented in connection with the Acquisition to rationalize product lines and align our workforce and operating costs with current business opportunities. This resulted in restructuring charges of \$6.1 million and \$38.3 million related to severance, termination benefits, write-off of property, plant and equipment and closing facilities during the three month and nine month ending September 30, 2013, respectively. The restructuring charges of \$0.2 million and \$6.5 million for the three and nine month period ending September 30, 2012, respectively, were related to the BigBand acquisition.

Acquisition and Other Costs

For the three and nine month period ending September 30, 2013, we recorded acquisition-related expense and integration expenses of \$6.2 million and \$32.8 million, respectively. These expenses related to the acquisition of Motorola Home and consisted of transaction costs and legal fees.

During the third quarter of 2012, we recorded acquisition related expenses of \$0.1 million. For the nine months period ending September 30, 2012, we recorded acquisition related expenses of \$0.7 million. These expenses were related to the acquisition of BigBand and consisted of transaction costs and integration related outside services.

Loss on Sale of Product Line

In March 2012, the Company completed the sale of certain assets of its ECCO electronic connector product line to Eclipse Embedded Technologies, Inc. for approximately \$3.9 million. The Company recorded a net loss of \$(0.3) million on the sale, which included approximately \$0.3 million of transaction related costs. The results of the ECCO product line were deemed immaterial to the overall financial results of the Company, and as such the Company has not reported the results in discontinued operations.

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Amortization of Intangible Assets

Intangibles amortization expense for the three months ended September 30, 2013 and 2012 was \$64.6 million and \$7.7 million, respectively. For the nine months ended September 30, 2013 and 2012, intangible amortization expense was \$127.8 million and \$22.6 million, respectively. Our intangible expense is related to the acquisitions of Motorola Home in April 2013, BigBand Networks in November 2011, Digeo, Inc. in October 2009, EG Technologies in September 2009, Auspice Corporation in August 2008 and C-COR Incorporated in December 2007.

Direct Contribution

The table below sets forth our direct contribution for the three and nine months ended September 30, 2013 and 2012, for each of our segments (in thousands):

	Direct Contribution				Increase (Decrease) Between 2013 and 2012			
	For the Three Months Ended		For the Nine Months Ended		For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,		September 30		September 30	
	2013	2012	2013	2012	\$	%	\$	%
Business Segment:								
CPE	\$ 150,383	\$ 25,017	\$ 295,018	\$ 45,369	\$ 125,366	501.1%	\$ 249,649	550.3%
N&C	59,566	44,857	183,220	167,638	14,709	32.8%	15,582	9.3%
Other	(121,093)	(38,766)	(345,162)	(121,171)	(82,387)	(212.5)%	(223,991)	(184.9)%
Total	\$ 88,856	\$ 31,108	\$ 133,076	\$ 91,836	\$ 57,748	185.6%	\$ 44,240	44.9%

Customer Premises Equipment Direct Contribution 2013 vs. 2012

During the three and nine months ended September 30, 2013, direct contribution in our CPE segment increased by approximately 501.1% and 550.3%, respectively, as compared to the same period in 2012. The increase is primarily attributable to the inclusion of direct contribution associated with our acquisition of Motorola Home. Further, the direct contribution is favorably impacted by mix, given, that in the aggregate the contribution margin of former Motorola Home products are greater than that of former ARRIS products.

Network and Cloud Direct Contribution 2013 vs. 2012

During the three and nine months ended September 30, 2013, direct contribution in our N&C segment increased by approximately 32.8% and 9.3%, respectively, as compared to the same period in 2012. Despite the higher sales, as a result of the Motorola Home acquisition, third quarter direct contribution did not increase materially. The third quarter contribution was impacted year over year by (1) higher operating expenses associated with investing in the acquired Cloud software portfolio, as well as overlapping investments in next generation CCAP (which is an area of synergy focus); (2) the ramp-up of E6000 CMTS in 2013 resulted in higher shipments of new chassis and line cards, which have lower margin relative to license upgrades of deployed C4 CMTS products shipped in 2012.

Other Expense (Income)

Interest Expense

Interest expense for the three months ended September 30, 2013 and 2012 was \$25.2 million and \$4.5 million respectively. For the nine months ended September 30, 2013 and 2012, interest expense was \$48.4 million and \$13.3 million respectively. Interest expense reflects the amortization of deferred finance fees, the non-cash interest component of our convertible subordinated notes, interest paid on the notes and term loans, and other debt obligations.

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Interest Income

Interest income during the three months ended September 30, 2013 and 2012 were \$0.8 million. During the nine months ended September 30, 2013 and 2012, interest income was \$2.3 million and \$2.2 million, respectively. The income reflects interest earned on cash, cash equivalents, short-term and long-term investments.

Loss (Gain) on Foreign Currency

During the three and nine months ended September 30, 2013, we recorded a foreign currency gain of approximately \$3.8 million and \$2.7 million, respectively. During the three months and nine months ended September 30, 2012, we recorded a foreign currency loss (gain) of approximately \$(0.4) million and \$0.9 million, respectively. We have certain international customers who are billed in their local currency. Additionally, certain intercompany transactions created in conjunction with the Motorola Home acquisition are denominated in foreign currencies and subject to revaluation. To mitigate the volatility related to fluctuations in the foreign exchange rates, we may enter into various foreign currency contracts. The loss (gain) on foreign currency is driven by the fluctuations in the foreign currency exchanges rates.

Loss (Gain) on Investments

From time to time, we hold certain investments in the common stock of private and publicly-traded companies, a number of non-marketable equity securities, and investments in rabbi trusts associated with our deferred compensation plans.

During the three months ended September 30, 2013 and 2012, we recorded net gain related to these investments of \$0.3 million, and \$0.9 million, respectively. During the nine months ended September 30, 2013 and 2012, we recorded net gains related to these investments of \$1.5 million.

Other Expense (Income)

Other (income) expense for the three months ended September 30, 2013 and 2012 was \$1.7 million and \$(0.1) million, respectively. For the nine months ended September 30, 2013 and 2012, other expense (income) was \$13.4 million and \$(0.8) million, respectively.

In connection with Comcast's agreement in January 2013 to invest in ARRIS upon the acquisition of Motorola Home, accounting guidance requires that, since the agreed-upon purchase price was less than the market price on the date of agreement, the resulting forward arrangement be marked to market for the difference in fair value. This resulted in a mark-to-market adjustment of \$13.2 million in the nine months ended September 30, 2013 and is recorded as Other Expense (Income).

Income Tax Expense

For the three and nine month periods ended September 30, 2013, we recorded income tax expense (benefit) of \$(28.0) million and \$(76.6) million, respectively, as compared to \$3.0 million and \$13.4 million, respectively in the same periods in 2012. The reduction in the income tax expense for the three and nine month periods ended September 30, 2013, compared to the three and nine month periods ended September 30, 2012, was primarily due to the change in earnings from continuing operations, as a result of the Acquisition and its related significant, infrequent and unusual book charges. Further benefits were recognized related to provision to return adjustments, as well as releases of liabilities for uncertain tax positions, related to the expiration of various periods during which federal, state and foreign taxing authorities can audit applicable returns.

For the nine month period ended September 30, 2013, we recorded a pre-tax book loss of approximately \$(71.1) million relating to the acquisition costs incurred in the Acquisition, on which a tax benefit of \$(23.6) was recorded; a pre-tax book loss of approximately \$(11.6) million on certain foreign entities from the Acquisition, on which no tax benefit was recorded; a tax benefit of approximately \$(8.6) million related to provision to return adjustments,

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including the 2012 research and development, a tax benefit of approximately \$(5.8) million on releases of liability for uncertain tax positions; and a pre-tax book loss of approximately \$(26.4) million on the Comcast investment in ARRIS, on which no tax benefit was recorded. The full year 2012 impact of the research and development tax credits was recognized in the three month period ended March 31, 2013, and was true-up with the filing of the federal income tax return in September 2013.

The only discrete tax event in the nine months ended September 30, 2012 was a tax benefit of approximately \$(4.2) million related to the release of liabilities related to uncertain tax positions and return to provision adjustments.

Financial Liquidity and Capital Resources

Overview

Following completion of the Motorola Home acquisition, one of our key strategies remains maintaining and improving our capital structure. The key metrics we focus on are summarized in the table below:

Liquidity & Capital Resources Data

	Nine Months Ended September 30,	
	2013	2012
	(in thousands, except DSO and turns)	
Key Working Capital Items		
Cash provided by operating activities	\$ 380,049	\$ 72,608
Cash, cash equivalents, and short-term investments	\$ 666,501	\$ 548,406
Long-term U.S. corporate & government agency bonds	\$ 28,477	\$ 22,796
Accounts receivable, net	\$ 627,844	\$ 171,143
Days Sales Outstanding (“DSOs”)	55 ⁽¹⁾	42
Inventory	\$ 350,919	\$ 137,496
Inventory turns	9.0 ⁽¹⁾	7.7
Key Financing Items		
Convertible notes at face value	\$ 231,972	\$ 232,050
Convertible notes at book value	\$ 231,972	\$ 218,943
Term loans at face value	\$ 1,893,375	\$ –
Key Shareholder Equity Items		
Cash used for share repurchases	\$ –	\$ 51,921
Capital Expenditures	\$ 53,383	\$ 14,520

⁽¹⁾ Using annualized activity from the third quarter 2013, the first full quarter as a combined company following the Acquisition.

In managing our liquidity and capital structure, we have been and are focused on key goals, and we have and will continue in the future to implement actions to achieve them. They include:

- Liquidity – ensure that we have sufficient cash resources or other short term liquidity to manage day to day operations
- Growth – implement a plan to ensure that we have adequate capital resources, or access thereto, to fund internal growth and execute acquisitions while retiring our convertible notes in a timely fashion.
- Timely debt retirement – implement a plan to retire the term loans.
- Share repurchases – opportunistically repurchase our common stock to the extent permitted under our credit agreements.

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Accounts Receivable & Inventory

We use the number of times per year that inventory turns over (based upon sales for the most recent period, or turns) to evaluate inventory management, and days sales outstanding, or DSOs, to evaluate accounts receivable management.

Accounts receivable increased during the first nine months of 2013 as compared to 2012 primarily as a result of the inclusion of sales associated with the Motorola Home products, which were not included in 2012. DSOs increased in 2013 as compared to 2012. As part of the Acquisition, we acquired approximately \$462.2 million of accounts receivable. Looking forward, it is possible that DSOs may increase dependent upon our customer mix and payment patterns, particularly if international sales increase as customers internationally typically have longer payment terms.

Inventory increased in the third quarter of 2013 as compared to 2012, primarily as a result of the Motorola Home acquisition. We acquired approximately \$279.6 million of inventory upon closing of the Motorola Home transaction in April 2013. Inventory turns during the first nine months of 2013 were 9.0 as compared to 7.7 in the same period of 2012.

Common Share Repurchases

During the first nine months of 2013, ARRIS did not repurchase any shares under the previously adopted share repurchase plan. During the first nine months of 2012, we repurchased 4.5 million shares of our common stock for \$51.9 million at an average stock price of \$11.55. We believe it is unlikely that we will repurchase a significant number of shares in the near-term.

2.00% Convertible Senior Notes due 2026

As a result of the holding company reorganization undertaken in connection with the Motorola Home acquisition, holders of the senior notes had the right (i) to require us to repurchase the senior notes for 100% of the principal amount of the senior notes, plus accrued and unpaid interest to, but not including the repurchase date and (ii) to convert the senior notes for the consideration provided for in the indenture governing the senior notes. See Note 14, *Long-Term Indebtedness* for further discussion.

In the second quarter of 2013, senior notes in the aggregate principal amount of \$68 thousand were tendered in connection with this repurchase right, and \$68 thousand of cash-on-hand was used to repurchase these notes. Also in the second quarter of 2013, eleven notes were submitted for conversion, and \$11 thousand of cash-on-hand was used to satisfy ARRIS' obligations on these notes. Following the repurchases and conversions, \$232.0 million in aggregate principal amount of the senior notes remain outstanding.

In October 2013, we announced that we would redeem all outstanding notes for face value on November 15, 2013. See Note 23, *Subsequent Events* for further discussion.

On October 17, 2013, ARRIS notified holders of the senior notes that it will redeem all outstanding notes (the "Redemption") on November 15, 2013 (the "Redemption Date") for cash at a price equal to 100% of the outstanding aggregate principal amount of the notes (the "Redemption Price"). The Redemption Price does not include the interest accrued up to November 15, 2013, which will be paid to the holders of the notes of record as of November 1, 2013.

Summary of Current Liquidity Position and Potential for Future Capital Raising

We believe our current liquidity position, where we have approximately \$666.5 million of cash, cash equivalents, and short-term investments and \$28.5 million of long-term marketable securities on hand as of September 30, 2013, together with approximately \$247.5 million in availability under our new Revolving Credit Facility entered into in connection with the Motorola Home acquisition. We believe that these sources, together with the prospects for continued generation of cash from operations, are adequate for our short- and medium-term business needs. Our cash and cash-equivalents as of September 30, 2013 include approximately \$201.6 million held by foreign

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subsidiaries whose earnings we expect to reinvest indefinitely outside of the United States. We do not expect to need the cash generated by those foreign subsidiaries to fund our domestic operations. However, in the unforeseen event that we repatriate cash from those foreign subsidiaries, in excess of what is owed to the United States parent, we may be required to provide for and pay U.S. taxes on permanently repatriated funds.

We expect to be able to generate sufficient cash on a consolidated basis to make all of the principal and interest payments under our senior secured credit facilities, indentures and other instruments governing our indebtedness. We expect to redeem the remaining outstanding senior notes in November 2013. Should our available funds be insufficient to support these initiatives or our operations, it is possible that we will raise capital through private or public, share or debt offerings.

Senior Secured Credit Facilities

In April 2013 we entered into senior secured credit facilities with Bank of America, N.A. and various other institutions, which are comprised of (i) a "Term Loan A Facility" of \$1.1 billion, (ii) a "Term Loan B Facility" of \$825 million and (iii) a "Revolving Credit Facility" of \$250 million. The Term Loan A Facility and the Revolving Credit Facility have terms of five years. The Term Loan B Facility has a term of seven years. Interest rates on borrowings under the senior credit facilities are set forth in the table below. As of September 30, 2013, we had \$1,893.4 million face value outstanding under the Term Loan A and Term Loan B Facilities, no borrowings under the Revolving Credit Facility and letters of credit totaling \$2.5 million issued under the Revolving Credit Facility.

	Rate	As of September 30, 2013
Term Loan A	LIBOR + 2.25 %	2.43%
Term Loan B	LIBOR ⁽¹⁾ + 2.75 %	3.50%
Revolving Credit Facility ⁽²⁾	LIBOR + 2.25 %	Not Applicable

(1) Includes LIBOR floor of 0.75%

(2) Includes unused commitment fee of 50 basis points not reflected in interest rate above.

Borrowings under the senior secured credit facilities are secured by first priority liens on substantially all of our assets and certain of our present and future subsidiaries who are or become parties to, or guarantors under, the credit agreement governing the senior secured credit facilities (the "Credit Agreement"). The Credit Agreement contains usual and customary limitations on indebtedness, liens, restricted payments, acquisitions and asset sales in the form of affirmative, negative and financial covenants, which are customary for financings of this type, including the maintenance of a minimum consolidated interest coverage ratio of not less than 3.5:1 and a maximum consolidated net leverage ratio of 4.25:1 (which decreases to 3.5:1 throughout the first two years of the Credit Agreement). As of September 30, 2013, we were in compliance with all covenants under the Credit Agreement.

The Credit Agreement provides terms for mandatory prepayments and optional prepayments and commitment reductions. The Credit Agreement also includes events of default, which are customary for facilities of this type (with customary grace periods, as applicable), including provisions under which, upon the occurrence of an event of default, all amounts outstanding under the credit facilities may be accelerated.

Commitments

As a result of the Motorola Home acquisition, our contractual obligations have significantly increased from the amounts shown in the table included in our Annual Report on Form 10-K for the year ended December 31, 2012. Included below is a summary of the additional contractual obligations that we have undertaken.

Following is a summary of our contractual obligations as of September 30, 2013 (in thousands):

<u>Contractual Obligations</u>	<u>Payments due by period</u>				<u>Total</u>
	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>	
Convertible notes ⁽¹⁾	\$ 231,972	\$ —	\$ —	\$ —	\$ 231,972
Credit facilities ⁽²⁾	63,250	181,500	869,000	779,625	1,893,375
Operating leases, net of sublease income ⁽³⁾	5,685	46,161	13,746	2,987	68,579
Purchase obligations ⁽⁴⁾	585,614	—	—	—	585,614
Total contractual obligations ⁽⁵⁾	<u>\$ 886,521</u>	<u>\$ 227,661</u>	<u>\$ 882,746</u>	<u>\$ 782,612</u>	<u>\$ 2,779,540</u>

(1) On October 17, 2013, we announced that we would redeem all outstanding convertible notes for face value on November 15, 2013. Does not include interest, which is payable at the rate of 2% per annum.

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- (2) Represents face values of Term Loan A and B which have terms of five years and seven years respectively.
- (3) Includes leases which are reflected in restructuring accruals on the consolidated balance sheets.
- (4) Represents obligations under agreements with non-cancelable terms to purchase goods or services. The agreements are enforceable and legally binding, and specify terms, including quantities to be purchased and the timing of the purchase.
- (5) Approximately \$27.9 million of uncertain tax position have been excluded from the contractual obligation table because we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authorities.

As part of the Acquisition, a subsidiary of Google Inc. has agreed to indemnify ARRIS for any losses suffered by the ARRIS related to certain specified retained litigation matters, subject to ARRIS being responsible for 50% of the first \$50 million in respect of past infringement and 50% of the first \$50 million in respect of certain future royalty payments related to the specified retained litigation matters, for a total obligation of \$50 million.

During the third quarter ended September 30, 2013, we settled certain of these specified retained litigation matters as follows:

TiVo

ARRIS, Google, Inc. and TiVo settled all claims associated with certain patent infringement litigation for \$196 million, which included non-exclusive, worldwide, non-transferable and perpetual license to the patents subject to the litigation. On the date the Settlement Agreement and Release was executed, we were legally responsible to TiVo for the liability arising from the litigation, if any. Payment was made in the quarter ended September 30, 2013. Google indemnified ARRIS for the amount of the payment except for the \$50 million for which we are responsible as described above.

Verizon

ARRIS, Google, Inc. and Verizon Sourcing LLC reached a settlement agreement, whereby ARRIS paid \$85 million to Verizon to settle patent infringement litigation in the quarter ended September 30, 2013. In consideration for this cash payment, we will have no further obligation for any indemnification of any claim arising from the Verizon claim. Google indemnified ARRIS for the full amount of our payment.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements as defined in Item 303(a) (4) (ii) of Regulation S-K.

Sources and Uses of Cash

The following table summarizes the net increases (decreases) in cash and equivalents for the key line items of our Consolidated Statements of Cash Flows for the periods presented (in thousands):

	For the Nine Months Ended	
	September 30,	
	<u>2013</u>	<u>2012</u>
<u>Cash provided by (used in)</u>		
Operating activities	\$ 380,049	\$ 72,608
Investing activities	(1,972,720)	(74,547)
Financing activities	2,002,082	(45,283)
Net increase (decrease) in cash and equivalents	<u>\$ 409,411</u>	<u>\$ (47,222)</u>

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Operating Activities:

Below are the key line items affecting cash provided by operating activities (in thousands):

	For the Nine Months Ended September 30,	
	2013	2012
Net (loss) income	\$ (44,380)	\$ 38,664
Adjustments to reconcile net income to cash provided by operating activities	180,153	59,811
Net income including adjustments	135,773	98,475
Decrease (increase) in accounts receivable	17,793	(19,515)
Decrease (increase) in inventory	60,345	(25,139)
Increase in accounts payable and accrued liabilities	155,265	2,614
All other – net	10,873	16,173
Cash provided by operating activities	\$ 380,049	\$ 72,608

Net income including adjustments, increased \$37.3 million during the first nine months of 2013 as compared to 2012.

Accounts receivable increased by \$17.8 million during the first nine months of 2013. These increases were primarily as a result of higher sales associated with acquisition of Motorola Home and payment patterns of our customers.

Inventory decreased by \$60.3 million during the first nine months of 2013. In the second quarter of 2013, there was a \$56 million reduction related to turnaround effect of inventory markup in purchase accounting.

Accounts payable and accrued liabilities increased by \$155.3 million. Accounts payable associated with the Motorola Home business increased from the close date of April 17, 2013 to September 30, 2013. We believe the quarter end value represents a normalized level.

All other accounts, net, include the changes in other receivables, income taxes payable (recoverable), and prepaids. The other receivables represent amounts due from our contract manufacturers for material used in the assembly of our finished goods. The change in our income taxes recoverable account is a result of the timing of the actual estimated tax payments during the year as compared to the actual tax liability for the year. The net change during the first nine months of 2013 was approximately \$10.9 million.

Investing Activities:

Below are the key line items affecting investing activities (in thousands):

	For the Nine Months Ended September 30,	
	2013	2012
Purchases of property, plant and equipment	\$ (53,383)	\$ (14,520)
Sale of property, plant and equipment	90	13
Purchases of investments	(104,547)	(235,348)
Sales of investments	393,234	172,059
Cash paid for acquisition, net of cash acquired	(2,208,114)	–
Sale of product line	–	3,249
Cash provided used in investing activities	\$ (1,972,720)	\$ (74,547)

Purchases of Property, Plant and Equipment – Represents capital expenditures which are mainly for test equipment, laboratory equipment, and computing equipment. It also represents expenditures related to the Motorola Home acquisition.

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Cash Proceeds from Sale of Property, Plant and Equipment – Represents the cash proceeds we received from the sale of property, plant and equipment.

Purchases and Sales of Investments – Represent purchases and sales of securities.

Cash Paid for Acquisition, Net of Cash Acquired – Represent cash investment we have made in our acquisitions.

Cash Proceeds from Sale of Product Line – Represents the cash proceeds we received from the sale of our ECCO product line.

Financing Activities:

Below are the key line items affecting our financing activities (in thousands):

	For the Nine Months Ended September 30,	
	2013	2012
Proceeds from issuance of debt	\$ 1,925,000	\$ –
Cash paid for debt discount	(9,853)	–
Payment of debt obligations	(31,625)	–
Early redemption of convertible notes	(79)	–
Deferred financing costs paid	(42,207)	–
Repurchase of common stock	–	(51,921)
Excess income tax benefits from stock-based compensation plans	6,417	2,614
Repurchase of shares to satisfy employee tax withholdings	(12,522)	(8,184)
Proceeds from issuance of common stock	166,951	12,208
Cash provided by (used in) financing activities	<u>\$ 2,002,082</u>	<u>\$ (45,283)</u>

Proceeds From Issuance of Debt – As part of the Motorola Home acquisition, we entered into senior secured credit facilities which comprised of Term Loan A facilities of \$1.1 billion with a term of five years and Term Loan B facilities of \$0.8 billion with a term of seven years.

Cash Paid for Debt Discount – Represents amounts paid to lenders in the form of upfront fees, which have been treated as a reduction in the proceeds received by the Company and are considered a component of the discount on the Term Loans A and B.

Payment of Debt Obligations – Represents the payment of the senior secured credit facilities term loans.

Early Redemption of Convertible Notes – As a result of the holding company reorganization undertaken in connection with the Acquisition, holders of the convertible notes had the right to require us to repurchase the convertible notes for 100% of the principal amount plus accrued and unpaid interest or to convert the convertible senior notes for the consideration provided for in the indenture governing the convertible notes. This represents the portion of the convertible notes that were tendered pursuant to the repurchase right and surrendered pursuant to the conversion right.

Deferred Financing Costs Paid – Represents the finance fees related to the issuance of the senior secured credit facilities. These costs will be amortized over the life of the term loans and revolving credit facility.

Repurchase of Common Stock – Represents the cash used to buy back the Company's common stock.

Excess Income Tax Benefits from Stock-Based Compensation Plans – Represents the cash that otherwise would have been paid for income taxes if increases in the value of equity instruments also had not been deductible in determining taxable income.

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Repurchase of Shares to Satisfy Tax Withholdings – Represents the minimum shares withheld to satisfy the tax withholding when restricted stock vests.

Proceeds from Issuance of Common Stock – Represents cash proceeds related to the exercise of employee stock options, offset by expenses paid related to issuance of common stock.

Interest Rates

As described above, all indebtedness under our senior secured credit facilities bears interest at variable rates based on LIBOR plus an applicable spread. We entered into interest rate swap arrangements to convert a notional amount of \$600.0 million of our variable rate debt based on one-month LIBOR to a fixed rate. This objective of these swaps is to manage the variability of cash flows in the interest payments related to the portion of the variable rate debt designated as being hedged.

Foreign Currency

A significant portion of our products are manufactured or assembled in China, Mexico and Taiwan, and we have research and development centers in China, India, Ireland, Israel, Russia and Sweden. Our sales into international markets have been and are expected in the future to be an important part of our business. These foreign operations are subject to the usual risks inherent in conducting business abroad, including risks with respect to currency exchange rates, economic and political destabilization, restrictive actions and taxation by foreign governments, nationalization, the laws and policies of the United States affecting trade, foreign investment and loans, and foreign tax laws.

We have certain international customers who are billed in their local currency. In addition, we have certain predictable expenditures for international operations in local currency. We use a hedging strategy and enter into forward or currency option contracts based on a percentage of expected foreign currency revenues and expenses. The percentage can vary, based on the predictability of the revenues denominated in the foreign currency.

Financial Instruments

In the ordinary course of business, we, from time to time, will enter into financing arrangements with customers. These financial arrangements include letters of credit, commitments to extend credit and guarantees of debt. These agreements could include the granting of extended payment terms that result in longer collection periods for accounts receivable and slower cash inflows from operations and/or could result in the deferral of revenue.

ARRIS executes letters of credit and bank guarantees in favor of certain landlords, customers and vendors to guarantee performance contracts. These cash collateral amounts are reported as restricted cash. As of September 30, 2013 and December 31, 2012, we had approximately \$1.8 million and \$4.7 million outstanding, respectively, of restricted cash.

Cash, Cash Equivalents, and Short-Term Investments

Our cash and cash equivalents (which are highly-liquid investments with an original maturity of three months or less) are primarily held in money market funds that pay either taxable or non-taxable interest. We hold short-term investments consisting of debt securities classified as available-for-sale, which are stated at estimated fair value. These debt securities consist primarily of commercial paper, certificates of deposits, and U.S. government agency financial instruments.

ARRIS holds cost method investments in private companies. These investments are recorded at \$6.0 million as of both September 30, 2013 and December 31, 2012. See Note 6 of Notes to the Consolidated Financial Statements for disclosures related to the fair value of our investments.

We have two rabbi trusts that are used as funding vehicles for various deferred compensation plans that were available to certain current and former officers and key executives. We also have deferred retirement salary plans, which were limited to certain current or former officers of C-COR. We hold investments to cover the liability.

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ARRIS also funds its nonqualified defined benefit plan for certain executives in a rabbi trust.

Capital Expenditures

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS' capital expenditures were \$53.4 million in the first nine months of 2013 as compared to \$14.5 million in the first nine months of 2012. Management expects to invest approximately \$70 million in capital expenditures for the fiscal year 2013, which includes the incremental purchases as a result of the recent acquisition of Motorola Home.

Critical Accounting Policies and Estimates

The accounting and financial reporting policies of ARRIS are in conformity with U.S. generally accepted accounting principles, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management has discussed the development and selection of the Company's critical accounting estimates with the audit committee of the Company's Board of Directors and the audit committee has reviewed the Company's related disclosures.

Our critical accounting policies and estimates are disclosed in our Form 10-K for the year ended December 31, 2012, as filed with the SEC. Our critical accounting estimates and the calculation methodology have not changed in any material respect during the nine months ended September 30, 2013.

Forward-Looking Statements

Certain information and statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this report, including statements using terms such as "may," "expect," "anticipate," "intend," "estimate," "believe," "plan," "continue," "could be," or similar variations or the negative thereof, constitute forward-looking statements with respect to the financial condition, results of operations, and business of ARRIS, including statements that are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and management's beliefs and assumptions regarding these markets. These and any other statements in this document that are not statements about historical facts are "forward-looking statements." We caution investors that forward-looking statements made by us are not guarantees of future performance and that a variety of factors could cause our actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Important factors that could cause results or events to differ from current expectations are described in the risk factors set forth in Part II, Item 1A. "Risk Factors." These factors are not intended to be an all-encompassing list of risks and uncertainties that may affect the operations, performance, development and results of our business. In providing forward-looking statements, ARRIS expressly disclaims any obligation to update publicly or otherwise these statements, whether as a result of new information, future events or otherwise except to the extent required by law.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes with respect to the information appearing in Part II, Item 7A., “Quantitative and Qualitative Disclosures About Market Risk,” of our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* Our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report (the “Evaluation Date”). Based on that evaluation, such officers concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective as contemplated by the Act.

(b) *Changes in Internal Control over Financial Reporting.* Our principal executive officer and principal financial officer evaluated the changes in our internal control over financial reporting that occurred during the most recent fiscal quarter. Except as described below, based on that evaluation, our principal executive officer and principal financial officer concluded that there had been no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. During the quarter ended June 30, 2013, we acquired the Motorola Home business and are in the process of integrating the acquired business into our overall internal control over financial reporting process. We expect to exclude the Motorola Home business from the assessment of internal control over financial reporting as of December 31, 2013.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We have been, and expect in the future to be a party to various legal proceedings, investigations or claims. In accordance with applicable accounting guidance, we record accruals for certain of our outstanding legal proceedings when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. We evaluate, at least on a quarterly basis, developments in our legal proceedings or other claims that could affect the amount of any accrual, as well as any developments that would result in a loss contingency to become both probable and reasonably estimable. When a loss contingency is not both probable and reasonably estimable, we do not record a loss accrual.

If the loss (or an additional loss in excess of any prior accrual) is reasonably possible and material, we disclose an estimate of the possible loss or range of loss, if such estimate can be made. The assessment whether a loss is probable or reasonably possible and whether the loss or a range of loss is estimable, involves a series of complex judgments about future events. Even if a loss is reasonably possible, we may not be able to estimate a range of possible loss, particularly where (i) the damages sought are substantial or indeterminate, (ii) the proceedings are in the early stages, or (iii) the matters involve novel or unsettled legal theories or a large number of parties. In such cases, there is considerable uncertainty regarding the ultimate resolution of such matters, including the amount of any possible loss. Accordingly, with respect to the proceedings described below, we are currently unable to reasonably estimate the possible loss or range of possible loss. However, because the results in litigation are unpredictable, an adverse resolution of one or more of such matters could have a material adverse effect on our business, financial position, results of operations or cash flows.

Due to the nature of our business, it is subject to patent infringement claims, including current suits against us or one or more of our wholly-owned subsidiaries or one or more of our customers who may seek indemnification from us. We believe that we have meritorious defenses to the allegation made in the pending cases and intend to vigorously defend these lawsuits; however, we are unable currently to determine the ultimate outcome of these or similar matters. In addition, we are a defendant in various litigation matters generally arising out of the normal course of business. Except as described below, ARRIS is not party (nor have indemnification claims been made with respect) to any proceedings that are, or reasonably are expected to be, material to its business, results of operations or financial condition. However, since it is difficult to predict the outcome of legal proceedings, it is possible that the

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ultimate outcomes could materially and adversely affect our business, financial position, results of operations or cash flows. Accordingly, with respect to these proceedings, we are currently unable to reasonably estimate the possible loss or range of possible loss.

British Telecom v. Cox; Comcast v. British Telecom, C.A. Nos. 10-658 (SLR); 11-843 (SLR), U.S. District Court, District of Delaware. On August 5, 2010 British Telecom sued Cox alleging infringement of four British Telecom U.S. patents, nos. 5,142,532, 5,526,350, 6,538,989 and 6,665,264, and subsequently amended the complaint to include four additional U.S. patents, nos. 5,790,643, 5,923,247, 6,205,216 and 6,473,742. Cox has asked ARRIS (and other suppliers, including Motorola) to indemnify them. Comcast also has requested indemnification for similar litigation with British Telecom over the same patents, and has filed a separate suit against British Telecom for infringement of unrelated patents. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Comcast and/or Cox, pay royalties and/or cease utilizing certain technology. With respect to the liability attributable to Motorola Home in this matter, a subsidiary of Google has agreed to indemnify ARRIS.

ARRIS v. SeaChange Int'l. (previously nCube v. SeaChange), C.A. No. 01-011 (JJF). U.S. District Court, District of Delaware. In May 2002, a jury found that video-on-demand products and software sold by SeaChange International ("SeaChange") infringed various claims of ARRIS' U.S. patent No. 5,805,804 and ARRIS was awarded enhanced damages and attorneys' fees based on the jury's finding of willful infringement. The District Court also entered a permanent injunction that, among other things, enjoined SeaChange from selling video-on-demand products and software that infringe U.S. patent no. 5,805,804. Following the District Court's entry of the permanent injunction, SeaChange initiated re-examination proceedings of the infringed claims before the United States Patent and Trademark Office ("USPTO"). The USPTO determined that most of the patent claims were patentable without any modification, including the infringed claim at issue in the contempt action.

In July 2009, ARRIS filed a motion for contempt, seeking to enforce the permanent injunction and an award of sanctions for SeaChange's continued sales of the video-on-demand products and software. In August 2009, in response to ARRIS' motion for contempt, SeaChange filed a declaratory-judgment suit seeking an order that its video-on-demand products and software do not infringe U.S. patent no. 5,805,804. In June 2010, the District Court stayed SeaChange's declaratory-judgment suit in favor of proceeding with ARRIS' motion for contempt. In October 2012, the court denied ARRIS' motion for a finding of contempt. ARRIS has filed an appeal of the denial of the contempt motion. Oral hearing on the appeal was held on August 6, 2013. The Appeal was denied on October 8, 2013. ARRIS is reviewing the opinion. There are no claims made against ARRIS and hence no loss exposure with respect to this case.

Bear Creek Technologies v. MSOs, C.A.No. 2:11-cv-00103, District of Delaware. In February 2011, Bear Creek sued MSOs, Telcos and other VoIP service providers for infringement of US patent no. 7,889,722, relating to EMTAs. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

KTech Telecommunications Inc. v. Time Warner Cable Inc., C.A. 2:11-cv-09373, Central District of California. On November 9, 2011, KTech Telecommunications filed suit against Time Warner Cable alleging infringement of U.S. patent nos. 6,785,903, 7,487,533, 7,761,893, and 7,984,469. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the Time Warner Cable, pay royalties and/or cease utilizing certain technology.

Sprint v. Time Warner Cable and Comcast, C.A. 11-cv-2684, District of Kansas. On December 19, 2011, Sprint filed suit against Time Warner Cable and Comcast alleging infringement of 12 patents alleged to cover various voice over internet protocol technologies. Comcast countersued, to which Sprint responded with allegations of infringement of more patents. The complaint requests unspecified damages for past infringement and an injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the

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likelihood of a favorable outcome. In the event of an unfavorable outcome ARRIS may be required to indemnify Time Warner Cable and/or Comcast, pay royalties and/or cease utilizing certain technology. With respect to the liability attributable to Motorola Home in this matter, a subsidiary of Google has agreed to indemnify ARRIS.

Williamson (At Home) v. Verizon and AT&T, C.A. 11-cv-04948, Southern District of New York. On July 19, 2011, Williamson filed suit against Verizon and AT&T on behalf of the At Home bankruptcy estate alleging infringement of four patents alleged to cover regionalized multicasting services. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. The case has been split, in that the defendants will have separate trials and the complaint against AT&T may be moved to the Northern District of Texas at an appropriate time. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T and Verizon, pay royalties and/or cease utilizing certain technology.

AIP v. MSOs, C.A. 12-cv-01690 et al., District of Delaware. On December 11, 2012, AIP filed several suits against service providers alleging infringement of four U.S. patents. The complaint requests unspecified damages for infringement and injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify one or more of the MSOs and/or pay royalties for utilizing certain technology.

Telecommunications Research Laboratories (dba TR Labs) v. Cablevision, C.A. 12-cv-06830, District of New Jersey. On November 2, 2012, TR Labs filed suit against Cablevision alleging infringement of seven U.S. Patents relating to network architecture. The complaint requests unspecified damages for infringement and injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Cablevision and/or pay royalties for utilizing certain technology.

C-Cation v. MSOs C.A. 11-cv-00030, Eastern District of Texas. On January 25, 2011, C-Cation filed suit against several service providers alleging infringement of U.S. Patent No. 5,841,840 relating to channel management. The complaint requests unspecified damages for past and future infringement. Trial is scheduled for December 9, 2013. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify one or more of the MSOs and/or pay royalties for utilizing certain technology.

Driden Multicomunications v. AT&T, C.A. 12-cv-01469, District of Delaware. On November 14, 2012, Driden filed suit against several service providers alleging infringement of U.S. Patent 5,563,883 relating to a multiple line modem. The complaint requests unspecified damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T and/or pay royalties for utilizing certain technology.

FutureVision.com v. MSOs, C.A. 12-cv-00386, Eastern District of Texas. On June 18, 2012, FutureVision.com filed suit against several service providers alleging infringement of U.S. Patent No. 5,877,755 relating to an interactive broadband multimedia systems. The complaint requests unspecified damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify one or more of the MSOs and/or pay royalties for utilizing certain technology.

Preservation Technologies v. AT&T, C.A. 11-cv-01860, Central District of California. On December 2, 2011, Preservation Tech. filed suit against several service providers alleging infringement of six U.S. patents. The complaint requests unspecified damages for infringement and injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T, pay royalties and/or cease utilizing certain technology.

US Ethernet Innovations v. AT&T, C.A. 10-cv-05254, Northern District of California. On November 19, 2010, US Ethernet Innovations filed suit against a multitude of parties alleging infringement of four U.S. patents, for which we

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believe ARRIS is indemnified by another supplier. The complaint requests unspecified damages for infringement and injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T, pay royalties and/or cease utilizing certain technology.

United Access Technologies v. AT&T, C.A. 11-cv-00338, District of Delaware. On April 15, 2011, United Access Technologies filed suit against AT&T alleging infringement of three U.S. patents. The complaint requests unspecified damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T and/or pay royalties for utilizing certain technology.

EON Corp. IP Holdings v. AT&T, C.A. 11-cv-01555, District of Puerto Rico. On June 14, 2011, EON filed suit against Motorola alleging infringement of six U.S. patents. The complaint requests unspecified damages for infringement and injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T, pay royalties and/or cease utilizing certain technology.

Cirrex Systems v. Verizon et al, C.A. 13-cv-00921; District of Delaware. Cirrex filed suit against Verizon and several equipment vendors including Motorola Solutions, Inc. The amended complaint alleges infringement of three US Patents. The complaint request unspecified damages for past infringement as well an injunction against future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Verizon, pay royalties and/or cease utilizing certain technology.

MediaTube et al v. Bell Canada et al, C.A. T-705-13, Canadian Federal Court. On April 23, 2013, MediaTube Corp. filed a claim against Bell Canada entities alleging infringement of a Canadian patent. The complaint requests damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Bell Canada for utilizing certain technology.

Custom Media Technologies v. MSOs, C.A. 13-cv-01425, District of Delaware. On August 15, 2013, Custom Media Technologies LLC filed a claim against several MSOs alleging infringement of US Patent No. 6,269,275. The complaint requests damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify one or more MSOs for utilizing certain technology.

Intellectual Ventures I and II v. AT&T, C.A. 12-cv-00193 and 13-cv-01631, District of Delaware. On February 16, 2012, Intellectual Ventures filed a claim against AT&T alleging infringement of several US patents. The complaint requests damages for past and future infringement. To date, no evidence of infringement or damages has been introduced. It is premature to assess the likelihood of an unfavorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T for utilizing certain technology.

Motorola Mobility v. Microsoft, C.A. 11-cv-01408, Western District of Washington. Motorola filed suit against Microsoft alleging infringement of multiple Motorola patents. Microsoft counterclaimed alleging infringement of several Microsoft patents, including two patents asserted against General Instrument products. It is premature to assess the likelihood of an unfavorable outcome. With respect to the liability attributable to Motorola Home in this matter, a subsidiary of Google has agreed to indemnify ARRIS.

Motorola Mobility v. Apple; Apple v. Motorola Mobility, C.A. 12-cv-20271, Southern District of Florida. Motorola filed suit against Apple alleging infringement of multiple Motorola patents. Apple counterclaimed alleging infringement of several Apple patents, including three patents asserted against General Instrument products. It is premature to assess the likelihood of an unfavorable outcome. With respect to the liability attributable to Motorola Home in this matter, a subsidiary of Google has agreed to indemnify ARRIS.

In the acquisition agreement entered into in connection with the acquisition of the Motorola Home business, a subsidiary of Google agreed to indemnify, defend and hold harmless ARRIS and various related parties with respect

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to, among other things, any losses suffered by ARRIS as a result of a court order involving, or the settlement of, certain agreed-upon litigation, including the five lawsuits described above that reference this indemnification obligation. There are various limitations upon this obligation, the most significant of which is that ARRIS was responsible for 50% of the first \$50.0 million (i.e., \$25.0 million) of losses attributable to past infringements as well as 50% of the first \$50.0 million (i.e., \$25.0 million) of future royalty payments and the costs of devising and implementing redesigns intended to avoid infringement. As a result of the settlement of Motorola Mobility's litigation with TiVo, these particular obligations for contribution by ARRIS have been exhausted and ARRIS has made the payments for which it is responsible.

From time to time third parties demand that we or our customers enter into a license agreement with respect to patents owned, or allegedly owned, by the third parties. Such demands cause us to dedicate time to study the patents and enter into discussions with the third parties regarding the merits and value, if any, of the patents. These discussions, may materialize into license agreements or patent claims asserted against us or our customers. If asserted against our customers, our customers may request indemnification from us. It is not possible to determine the impact of any such demands and the related discussions on ARRIS' business, results of operations or financial condition.

Item 1A. Risk Factors

Our business is dependent on customers' capital spending on broadband communication systems, and reductions by customers in capital spending adversely affect our business.

Our performance is primarily dependent on customers' capital spending for constructing, rebuilding, maintaining or upgrading broadband communications systems. Capital spending in the telecommunications industry is cyclical and can be curtailed or deferred on short notice. A variety of factors affect capital spending, and, therefore, our sales and profits, including:

- general economic conditions;
- customer specific financial or stock market conditions;
- availability and cost of capital;
- governmental regulation;
- demands for network services;
- competition from other providers of broadband and high-speed services;
- acceptance of new services offered by our customers; and
- real or perceived trends or uncertainties in these factors.

Several of our customers have accumulated significant levels of debt. These high debt levels, coupled with the continued turbulence and uncertainty in the capital markets, may impact their access to capital in the future. Even if the financial health of our customers remains intact, these customers may not purchase new equipment at levels we have seen in the past or expect in the future. While there are signs of improvement from the historical housing market disruptions and foreclosures, as well as the material disruptions in the credit markets that began in 2008, we cannot predict the impact, if any, of continued economic uncertainty or of specific customer financial challenges on our customer's expansion and maintenance expenditures.

The markets in which we operate are intensely competitive, and competitive pressures may adversely affect our results of operations.

The broadband communication systems industry is extremely competitive and dynamic, requiring the companies that compete in the industry to react quickly and capitalize on change. This requires us to retain skilled and experienced personnel as well as to deploy substantial resources toward meeting the ever-changing demands of the industry. We compete with national and international manufacturers, distributors and wholesalers including many companies that are larger than we are. Our major competitors include:

- Casa Systems, Inc.;
- Cisco Systems, Inc.;
- Commscope, Inc.;
- Concurrent Computer Corporation;
- Emcore Corporation;
- Ericsson (TandbergTV);
- Harmonic, Inc.;
- Hitron Technologies Americas, Inc.;
- Huawei;
- Pace Plc;
- RGB;
- Samsung Electronics Company, Ltd;
- SeaChange, Inc.;
- SMC Networks;
- Technicolor, Inc.;
- TVC Communications, Inc.;
- Ubee Interactive, Inc.;
- Vecima Networks Inc.; and
- ZTE

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In some instances, notably our software products, our customers themselves may be our competition as they may develop their own software. The rapid technological changes occurring in broadband may lead to the entry of new competitors, including those with substantially greater resources than our own. Because the markets in which we compete are characterized by rapid growth and, in some cases, low barriers to entry, smaller niche market companies and start-up ventures also may become principal competitors in the future. Actions by existing competitors and the entry of new competitors may have an adverse effect on our sales and profitability. In the future, technological advances could lead to the obsolescence of some of our current products, which could have a material adverse effect on our business.

Further, many of our larger competitors are in a better position to withstand any significant, sustained reduction in capital spending by customers. They often have broader product lines and market focus and therefore are not as susceptible to downturns in a particular market. In addition, several of our competitors have been in operation longer than we have been, and therefore they have more established relationships with domestic and foreign broadband service users. We may not be able to compete successfully in the future, and competition may negatively impact our business.

Consolidations in the telecommunications industry could result in delays or reductions in purchases of products, which would have a material adverse effect on our business.

The telecommunications industry has experienced the consolidation of many industry participants. When consolidations occur, it is possible that the acquirer will not continue using the same suppliers, thereby possibly resulting in an immediate or future elimination of sales opportunities for us or our competitors. Consolidations also could result in delays in purchasing decisions by the merged businesses. The purchasing decisions of the merged companies could have a material adverse effect on our business.

Our business is highly concentrated in the telecommunications industry, which is significantly impacted by technological change and open architecture solutions.

The cable television industry has gone through dramatic technological change resulting in MSOs rapidly migrating their business from a one-way television service to a two-way communications network enabling multiple services, such as high-speed Internet access, residential telephony services, business telephony services and Internet access, digital television, video on demand and advertising services. New services that are, or may be offered by MSOs and other service providers, such as home security, power monitoring and control, high definition television, 3-D television, and a host of other new home services are also based on and will be characterized by rapidly evolving technology. The development of increasing transmission speed, density and bandwidth for Internet traffic has also enabled the provision of high quality, feature length video over the Internet. This so called over-the-top IP video service enables content providers such as Netflix, Hulu and CBS and portals like Google to provide video services on-demand, by-passing traditional video service providers. As these service providers enhance their quality and scalability, MSOs are moving to match them and provide even more competitive services over their existing networks, as well as over-the-top IP video for delivery not only to televisions but to computers, tablets, and telephones in order to remain competitive. Our business is dependent on our ability to develop products that enable current and new customers to exploit these rapid technological changes. We believe the growth of over-the-top IP video represents a shift in the traditional video delivery paradigm, and we cannot predict the effect it will have on our business.

In addition, the cable industry has and will continue to demand a move toward open standards. The move toward open standards is expected to increase the number of MSOs that will offer new services. This trend is expected to increase the number of competitors and drive down the capital costs per subscriber deployed. These factors may adversely impact both our future revenues and margins.

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The completion of the Motorola Home acquisition will have a significant impact on our operations and financial statements going forward.

In April 2013, we completed our acquisition of Motorola Home, whose business was significantly larger than ours prior to the acquisition. For the year ended December 31, 2012, Motorola Home had net sales of approximately \$3.3 billion and total assets of approximately \$2.5 billion, compared with our net sales of approximately \$1.4 billion and total assets of \$1.4 billion as of and for the year ended December 31, 2012. In addition, we increased our long-term debt by approximately \$1.9 billion in connection with the acquisition. Given the significant increase in the size of our business as a result of the acquisition and the increase in our long-term debt, our historical results are not indicative of our combined operations going forward.

The anticipated benefits from acquiring the Motorola Home business may not be realized.

We acquired Motorola Home with the expectation that the transaction would result in various benefits, including, among other things, enhancing our current and future product offerings, strengthening our ability to capitalize on and manage changing industry trends and broadening our customer base.

The acquisition involves the combination of two companies that previously operated independently. The difficulties of combining Motorola Home's operations with ours include:

- combining the best practices of two companies, including research and development and sales functions;
- the necessity of coordinating geographically separated organizations, systems and facilities;
- integrating personnel with diverse business backgrounds and organizational cultures;
- reducing the costs associated with each company's operations; and
- preserving important relationships of both ARRIS and Motorola Home and resolving potential conflicts that may arise.

The process of combining operations could cause an interruption of, or loss of momentum in, our business and the possible loss of key personnel. The diversion of management's attention and any delays or difficulties encountered in connection with the acquisition and the integration of the two companies' operations could have an adverse effect on the business, results of operations, financial condition or prospects of the combined company after the acquisition. In addition, we may experience unexpected difficulties and/or delays in combining Motorola Home systems with ours, including the subsequent testing related to applicable internal controls, in a timely fashion which could have an adverse effect on our operations.

In addition, our ability to achieve the anticipated benefits of the acquisition is subject to a number of uncertainties discussed elsewhere, including:

- our ability to take advantage of expected growth opportunities;
- general market and economic conditions;
- general competitive factors in the industry and marketplace; and
- higher than expected costs required to achieve the anticipated benefits of the acquisition.

No assurance can be given that these benefits will be achieved or, if achieved, the timing of their achievement. Failure to achieve these anticipated benefits could result in increased costs and decreases in expected revenues and/or net income following the acquisition.

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Our business has come primarily from a few key customers. The loss of one of these customers or a significant reduction in sales to one of these customers would have a material adverse effect on our business.

Our three largest customers (including their affiliates, as applicable) are Comcast, Time Warner Cable and Verizon. For the nine months ended September 30, 2013, sales to Comcast accounted for approximately 18.7% of our total revenue, sales to Time Warner Cable accounted for approximately 11.4% of our total revenue and sales to Verizon accounted for approximately 8.6% of our total revenue. While we expect greater overall customer diversification as a result of the Motorola Home acquisition, we also expect that sales to several customers, including Verizon, will significantly increase. The loss of one of our large customers, or a significant reduction in the products or services provided to any of them would have a material adverse impact on our business. For many of these customers, we also are one of their largest suppliers. As a result, if from time-to-time customers elect to purchase products from our competitors in order to diversify their supplier base and to dual-source key products or to curtail purchasing due to budgetary or market conditions, such decisions could have material consequences to our business. In addition, because of the magnitude of our sales to these customers the terms and timing of our sales are heavily negotiated, and even minor changes can have a significant impact upon our business.

We may face higher costs associated with protecting our intellectual property or obtaining necessary access to the intellectual property of others.

Our future success depends in part upon our proprietary technology, product development, technological expertise and distribution channels. We cannot predict whether we can protect our technology or whether competitors can develop similar technology independently. We have received, directly or indirectly, and expect to continue to receive, from third parties, including some of our competitors, notices claiming that we, or our customers using our products, have infringed upon third-party patents or other proprietary rights. We are a defendant in several proceedings (and other proceedings have been threatened) in which our customers were sued for patent infringement and sued, or made claims against, us and other suppliers for indemnification, and we may become involved in similar litigation involving these and other customers in the future, including as a result of our acquisition of Motorola Home. These claims, regardless of their merit, could result in costly litigation, divert the time, attention and resources of our management, delay our product shipments, and, in some cases, require us to enter into royalty or licensing agreements. If a claim of product infringement against us is successful and we fail to obtain a license or develop non-infringing technology, our business and operating results could be materially and adversely affected. In addition, the payment of any damages or any necessary licensing fees or indemnification costs associated with a patent infringement claim could be material and could also materially adversely affect our operating results.

Our indebtedness significantly increased in connection with our Motorola Home acquisition, which could limit our operations and opportunities, make it more difficult for us to pay or refinance our debts and/or may cause us to issue additional equity in the future, which would increase the dilution of our stockholders or reduce earnings.

As of September 30, 2013, we had approximately \$2.1 billion in total indebtedness. In connection with the acquisition of Motorola Home, we incurred approximately \$1.9 billion of additional debt. In addition, we obtained a \$250 million revolving line of credit to support our working capital needs following the acquisition. Our debt service obligations with respect to this increased indebtedness could have an adverse impact on our earnings and cash flows for as long as the indebtedness is outstanding.

This increased indebtedness could also have important consequences to stockholders. For example, it could:

- make it more difficult for us to pay or refinance our debts as they become due during adverse economic and industry conditions because any decrease in revenues could cause us to not have sufficient cash flows from operations to make our scheduled debt payments;
- limit our flexibility to pursue other strategic opportunities or react to changes in our business and the industry in which we operate and, consequently, place us at a competitive disadvantage to competitors with less debt;

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- require a substantial portion of our cash flows from operations to be used for debt service payments, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes; and
- result in higher interest expense in the event of increases in interest rates since the majority of our debt is subject to variable rates.

Based upon current levels of operations, we expect to be able to generate sufficient cash on a consolidated basis to make all of the principal and interest payments when such payments are due under our senior secured credit facilities, indentures and other instruments governing our indebtedness; but there can be no assurance that we will be able to repay or refinance such borrowings and obligations.

We may consider it appropriate to reduce the amount of indebtedness currently outstanding. This may be accomplished in several ways, including issuing additional shares of common stock or securities convertible into shares of common stock, reducing discretionary uses of cash or a combination of these and other measures. Issuances of additional shares of common stock or securities convertible into shares of common stock would have the effect of diluting the ownership percentage that stockholders will hold in the company and might reduce our reported earnings per share.

We have substantial goodwill and amortizable intangible assets.

Our financial statements reflect substantial goodwill and intangible assets, approximately \$926.8 million and \$1,239.2 million, respectively, as of September 30, 2013, that was recognized in connection with the acquisitions including the Motorola Home acquisition.

We annually (and more frequently if changes in circumstances indicate that the asset may be impaired) review the carrying amount of our goodwill in order to determine whether it has been impaired for accounting purposes. In general, if the fair value of the corresponding reporting unit's goodwill is less than the carrying value of the goodwill, we record an impairment. The determination of fair value is dependent upon a number of factors, including assumptions about future cash flows and growth rates that are based on our current and long-term business plans. With respect to the amortizable intangible assets, we test recoverability when events or changes in circumstances indicate that their carrying amounts may not be recoverable. Examples of such circumstances include, but are not limited to, operating or cash flow losses from the use of such assets or changes in our intended uses of such assets. If we determine that an asset or asset group is not recoverable, then we would record an impairment charge if the carrying value of the asset or asset group exceeds its fair value. Fair value is based on estimated discounted future cash flows expected to be generated by the asset or asset group. The assumptions underlying cash flow projections would represent management's best estimates at the time of the impairment review.

We recorded a non-cash goodwill impairment charge of \$41.2 million and a non-cash intangible asset impairment charge of \$47.4 million relating to our former Media and Communications Systems segment (now included in our Network and Cloud segment) during the fourth quarter of 2011. No goodwill or intangible asset impairments were recorded in 2012. As the ongoing expected cash flows and carrying amounts of our remaining goodwill and intangible assets are assessed, changes in the economic conditions, changes to our business strategy, changes in operating performance or other indicators of impairment could cause us to realize additional impairment charges in the future. For additional information, see the discussion under "Critical Accounting Policies" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012.

We may have difficulty in forecasting our sales.

Because a significant portion of the purchases by our customers are discretionary and because of the recent completion of the acquisition of Motorola Home, to accurately forecasting sales is difficult. In addition, in recent years our customers have submitted their purchase orders less evenly over the course of each quarter and year and with shorter lead times than they have historically. This has made it even more difficult for us to forecast sales and other financial measures, which can result in us maintaining inventory levels that are too high or too low for our ultimate needs.

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Products currently under development may fail to realize anticipated benefits.

Rapidly changing technologies, evolving industry standards, frequent new product introductions and relatively short product life cycles characterize the markets for our products. The technology applications that we currently are developing may not ultimately be successful. Even if the products in development are successfully brought to market, they may not be widely used or we may not be able to capitalize successfully on their technology. To compete successfully, we must quickly design, develop, manufacture and sell new or enhanced products that provide increasingly higher levels of performance and reliability. However, we may not be able to develop or introduce these products successfully if they:

- are not cost-effective;
- are not brought to market in a timely manner;
- fail to achieve market acceptance; or
- fail to meet industry certification standards.

Furthermore, our competitors may develop similar or alternative technologies that, if successful, could have a material adverse effect on us. Our strategic alliances are based on business relationships that have not been the subject of written agreements expressly providing for the alliance to continue for a significant period of time. The loss of a strategic relationship could have a material adverse effect on the progress of new products under development with that third party.

Our success depends on our ability to attract and retain qualified personnel in all facets of our operations.

Competition for qualified personnel is intense, and we may not be successful in attracting and retaining key personnel, which could impact our ability to maintain and grow our operations. Our future success will depend, to a significant extent, on the ability of our management to operate effectively. In the past, competitors and others have attempted to recruit our employees and their attempts may continue. The loss of services of any key personnel, the inability to attract and retain qualified personnel in the future or delays in hiring required personnel, particularly engineers and other technical professionals, could negatively affect our business.

We are substantially dependent on contract manufacturers, and an inability to obtain adequate and timely delivery of supplies could adversely affect our business.

Many components, subassemblies and modules necessary for the manufacture or integration of our products are obtained from a sole supplier or a limited group of suppliers. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our reliance on subcontractors involves several risks including a potential inability to obtain an adequate supply of required components, subassemblies or modules and reduced control over pricing, quality and timely delivery of components, subassemblies or modules. An inability to obtain adequate deliveries or any other circumstance that would require us to seek alternative sources of supply could affect our ability to ship products on a timely basis. Any inability to reliably ship our products on time could damage relationships with current and prospective customers and harm our business.

Our international operations would be adversely affected by any decline in the demand for broadband systems designs and equipment in international markets.

Sales of broadband communications equipment into international markets are an important part of our business and these international sales are expected to increase as a result of the Motorola Home acquisition. Our products are marketed and made available to existing and new potential international customers. In addition, United States broadband system designs and equipment are increasingly being employed in international markets, where market penetration is relatively lower than in the United States. While international operations are expected to comprise an integral part of our future business, international markets may no longer continue to develop at the current rate, or at all. We may fail to receive additional contracts to supply equipment in these markets.

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Our international operations may be adversely affected by changes in the foreign laws in the countries in which we and our manufacturers and assemblers have plants.

A significant portion of our products are manufactured or assembled in China, Mexico and Taiwan. The governments of the foreign countries in which our products are manufactured may pass laws that impair our operations, such as laws that impose exorbitant tax obligations or nationalize these manufacturing facilities.

In addition, we own a manufacturing facilities located in Tijuana, Mexico and Taipei, Taiwan. These operations are exposed to certain risks as a result of its location, including:

- changes in international trade laws including those affecting our import and export activities;
- changes in labor laws and regulations affecting our ability to hire and retain employees;
- fluctuations of foreign currency and exchange controls;
- potential political instability and changes in government;
- potential regulatory changes; and
- general economic conditions

Any of these risks could interfere with the operation of this facility and result in reduced production, increased costs, or both. In the event that production capacity of this facility is reduced, we could fail to ship products on schedule and could face a reduction in future orders from dissatisfied customers. If our costs to operate this facility increase, our margins would decrease. Reduced shipments and margins would have an adverse effect on our financial results.

Regional instability in Israel may adversely affect business conditions, including the operations of our contract manufacturers, and may disrupt our operations and negatively affect our operating results.

A portion of our research and development operations and a portion of our contract manufacturing occur in Israel. We also have customer service, marketing and general and administrative employees at our Israeli facility. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel, and any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its trading partners could significantly harm our business. In addition, in the past, Israel and companies doing business with Israel have been the subject of economic boycott. Israel has also been and continues to be subject to civil unrest and terrorist activity, with varying levels of severity. Security and political conditions may have an adverse impact on our business in the future. Hostilities involving Israel or the interruption or curtailment of trade between Israel and its trading partners could adversely affect our operations and make it more difficult for us to retain or recruit qualified personnel in Israel.

In addition, most of our employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and several have been called for active military duty in connection with intermittent hostilities over the years. Should hostilities in the region escalate again, some of our employees would likely be called to active military duty, possibly resulting in interruptions in our sales and development efforts and other impacts on our business and operations, which we cannot currently assess.

We face risks relating to currency fluctuations and currency exchange.

On an ongoing basis we are exposed to various changes in foreign currency rates because significant sales are denominated in foreign currencies. Additionally, certain intercompany transactions created in conjunction with the Motorola Home acquisition are denominated in foreign currencies and subject to revaluation. These changes can impact our results of operations, cash flows and financial position. We manage these risks through regular operating and financing activities and periodically use derivative financial instruments such as foreign exchange forward and option contracts. There can be no assurance that our risk management strategies will be effective.

We also may encounter difficulties in converting our earnings from international operations to U.S. dollars for use in the United States. These obstacles may include problems moving funds out of the countries in which the funds were earned and difficulties in collecting accounts receivable in foreign countries where the usual accounts receivable payment cycle is longer.

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We depend on channel partners to sell our products in certain regions and are subject to risks associated with these arrangements.

We utilize distributors, value-added resellers, system integrators, and manufacturers' representatives to sell our products to certain customers and in certain geographic regions to improve our access to these customers and regions and to lower our overall cost of sales and post-sales support. Our sales through channel partners are subject to a number of risks, including:

- ability of our selected channel partners to effectively sell our products to end customers;
- our ability to continue channel partner arrangements into the future since most are for a limited term and subject to mutual agreement to extend;
- a reduction in gross margins realized on sale of our products; and
- a diminution of contact with end customers which, over time, could adversely impact our ability to develop new products that meet customers' evolving requirements.

As a holding company, we are dependent on the operations and funds of our subsidiaries.

On April 16, 2013, we completed a reorganization pursuant to which ARRIS became a holding company with no business operations of its own. ARRIS' only significant assets are the outstanding equity interests in its subsidiaries, including those acquired with Motorola Home. As a result, we rely on payments from our subsidiaries to meet our obligations.

We currently expect that a significant portion of the cash flows of our subsidiaries will be retained and used by them in their operations, including servicing any debt obligations of ARRIS. Additionally, under the terms of our senior secured credit facilities, our subsidiaries may be restricted in their ability to pay cash dividends or to make other distributions to the new holding company. Also, we have substantial cash held at our foreign subsidiaries that we consider permanently invested.

The acquisition of Motorola Home may not be accretive to our earnings and may cause dilution to our earnings per share, which may negatively affect the market price of our common stock.

We currently anticipate that the acquisition will be accretive to our earnings per share in the first full year following the completion of the acquisition and thereafter. This expectation is based on preliminary estimates that may materially change. We may encounter additional integration-related costs, may fail to realize all of the benefits anticipated in the acquisition or be subject to other factors that adversely affect preliminary estimates. Any of these factors could cause delay or significantly reduce the expected accretive effect of the acquisition and contribute to a decrease in the price of our common stock.

Our stock price has been and may continue to be volatile.

Our common stock is currently traded on The NASDAQ Global Select Market. The trading price of our common stock has been and may continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors including:

- future announcements concerning us, key customers or competitors;
- quarterly variations in operating results;
- changes in financial estimates and recommendations by securities analysts;
- developments with respect to technology or litigation;
- the operating and stock price performance of our competitors; and
- acquisitions and financings.

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Fluctuations in the stock market, generally, also impact the volatility of our stock price. General stock market movements may adversely affect the price of our common stock, regardless of our operating performance.

Cyber-security incidents, including data security breaches or computer viruses, could harm our business by disrupting our delivery of services, damaging our reputation or exposing us to liability.

We receive, process, store and transmit, often electronically, the confidential data of our clients and others. Unauthorized access to our computer systems or stored data could result in the theft or improper disclosure of confidential information, the deletion or modification of records or could cause interruptions in our operations. These cyber-security risks increase when we transmit information from one location to another, including transmissions over the Internet or other electronic networks. Despite implemented security measures, our facilities, systems and procedures, and those of our third-party service providers, may be vulnerable to security breaches, acts of vandalism, software viruses, misplaced or lost data, programming and/or human errors or other similar events which may disrupt our delivery of services or expose the confidential information of our clients and others. Any security breach involving the misappropriation, loss or other unauthorized disclosure or use of confidential information of our clients or others, whether by us or a third party, could (i) subject us to civil and criminal penalties, (ii) have a negative impact on our reputation, or (iii) expose us to liability to our clients, third parties or government authorities. Any of these developments could have a material adverse effect on our business, results of operations and financial condition. We have not experienced any such incidents that have material consequences to date.

We do not intend to pay cash dividends in the foreseeable future.

We do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, our ability to pay dividends is limited by the terms of our senior secured credit facilities. Payment of dividends in the future will depend on, among other things, business conditions, our results of operations, cash requirements, financial condition, contractual restrictions, provisions of applicable law and other factors that our board of directors may deem relevant.

We have the ability to issue preferred shares without stockholder approval.

Our common stock may be subordinate to classes of preferred shares issued in the future in the payment of dividends and other distributions made with respect to common stock, including distributions upon liquidation or dissolution. Our Amended and Restated Certificate of Incorporation permits our board of directors to issue preferred shares without first obtaining stockholder approval. If we issued preferred shares, these additional securities may have dividend or liquidation preferences senior to the common stock. If we issue convertible preferred shares, a subsequent conversion may dilute the current common stockholders' interest.

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Item 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
31.1	Section 302 Certification of Chief Executive Officer, filed herewith
31.2	Section 302 Certification of Chief Financial Officer, filed herewith
32.1	Section 906 Certification of Chief Executive Officer, filed herewith
32.2	Section 906 Certification of Chief Financial Officer, filed herewith
101.INS	XBRL Instant Document, filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document, filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document, filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document, filed herewith
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document, filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document, filed herewith

SIGNATURES

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

ARRIS GROUP, INC.

/s/ David B. Potts

David B. Potts

Executive Vice President, Chief Financial Officer and Chief
Accounting Officer

Dated: November 8, 2013

Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2002

I, Robert J. Stanzione, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ARRIS Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for internal purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2013

/s/ RJ Stanzione

Robert J. Stanzione
Chief Executive Officer, Chairman

Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2002

I, David B. Potts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ARRIS Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for internal purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2013

/s/ David B. Potts

David B. Potts
Executive Vice President, Chief Financial Officer and Chief Accounting Officer

Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)

The undersigned, as the chief executive officer of ARRIS Group, Inc., certifies that to the best of his knowledge the Quarterly Report on Form 10-Q for the period ended September 30, 2013, which accompanies this certification fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the quarterly report fairly presents, in all material respects, the financial condition and results of operations of ARRIS Group, Inc. at the dates and for the periods indicated. The foregoing certification is made pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350) and shall not be relied upon for any other purpose.

Dated this 8th day of November, 2013

/s/ RJ Stanzone

Robert J. Stanzone
Chief Executive Officer, Chairman

Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)

The undersigned, as the chief financial officer of ARRIS Group, Inc., certifies that to the best of his knowledge the Quarterly Report on Form 10-Q for the period ended September 30, 2013, which accompanies this certification fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the quarterly report fairly presents, in all material respects, the financial condition and results of operations of ARRIS Group, Inc. at the dates and for the periods indicated. The foregoing certification is made pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350) and shall not be relied upon for any other purpose.

Dated this 8th day of November, 2013

/s/ David B. Potts

David B. Potts

Executive Vice President, Chief Financial Officer and Chief
Accounting Officer

