

FINAL TRANSCRIPT

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ARM.L - Q2 2010 ARM Holdings plc Earnings Conference Call

Event Date/Time: Jul. 27. 2010 / 8:30AM GMT



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PRESENTATION

Warren East - *ARM Holdings plc - CEO*

Okay. Good morning, everybody, and welcome to our Q2 and first half results presentation and for those of you on the line on the call. It's great to see everybody. You'll -- those of you to whom I've spoken close-up, I'm permitting myself the champagne bottle tie this morning, because we're quite pleased with our results for the first half. And we'll go into a bit of detail on that right now, as soon as I can advance the slides.

So, as I say, a very good set of results. Obviously, trading conditions in the first half of 2010, for everybody in our industry, have improved compared with 2009. But what's really good about the ARM position halfway through 2010 is that we feel we're very well positioned for long-term growth.

The outperformance of the industry right throughout the cycle has continued. Our revenues, profitability and earnings that I'm sure we'll talk about this morning all reflect that. And that's because in these key market sectors, with long-term structural growth that we've been talking about for some time, we're continuing to gain market share.

And during the quarter we've also had some very high-profile announcements, with industry leaders adopting ARM technology sometime -- for the first time generally for deeper use of ARM technology. And that's all very good and bodes very well for the future.



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Our physical IP I'll talk about in a few moments. But we've had some great progress there as well. And on a day-to-day basis, business is in good shape. Orders coming in, which position our backlog at absolutely record levels after a strong quarter. So we're feeling good.

We have continued with our regime of pretty strict financial discipline. And that's led to healthy margins, which have in turn led to healthy cash generation, as well as permitting increased investment in R&D through the quarter. And indeed, as we move into the second half of the year, you'll see us do more of that.

The slide is the standard format, reminding everybody of our axes of strategic growth. And we're reporting progress in all of those three areas this quarter, so very good.

Now I'll just go straight into the detail, down one level, and we'll start with the Processor business and processor licensing. It was a very good quarter, actually a record bookings quarter, which has driven the backlog to a record as well, but by some margin. We have continued to grow our base of processor licenses at a steady rate, continuing to grow the installed base.

And there are several announcements which happened during the quarter. Obviously last Friday, a high-profile announcement from Microsoft. But the more normal licensing which sits behind that is in very good shape too. We've had five licenses for Cortex-A class processors. And we've now got a full line-up of lead partners for Eagle, our new Cortex-A class product, which will be launched a bit later in the year.

At the other end of the spectrum, the microcontroller end, we've had additional licenses for Cortex-M class products. And we've had some microcontroller announcements as well.

Looking at our graphics portfolio then, we're very pleased with further commitments from our partners for Mali. And the licenses with potential to generate future royalties there have now incremented up to 29.

The pie chart on the bottom is a familiar pie chart to you now. We've used this format before. But we're putting it there to continue to remind people that non-mobile is still a strong driver for our new licensing, so people taking licenses for digital televisions, for microcontrollers and some of those microcontrollers being used in new applications such as smartmeters.

We've also seen, in the mobile space, some new customers who've come to the ARM party for mobile in the last couple of years, starting now to create their chips and get their chips out into the marketplace and come back for more licenses as well. So that's pretty encouraging.

Now a little deviation from the standard format of the presentation. As I said, last week we had a high-profile announcement with Microsoft, or rather perhaps a low-profile announcement with a high-profile company. And this slide is here because we could spend a lot of the Q&A talking about the Microsoft announcement. We can't talk much about it, and this is as much as we are able to say this morning.

Though the facts are, Microsoft have bought an architecture license from ARM. Architecture licenses allow customers to build their own implementations of ARM microprocessors which are fully compatible with the ARM instruction set. It is a multi-year agreement which enables them to work more closely with us. Microsoft have actually been collaborating with ARM for many years. It says on the slide 13 years. My arithmetic's not too good, but I think it's probably getting on for 14 years now actually. And Microsoft have brought several of their operating systems to the ARM architecture in that time.

And those are the facts. And there's really not much more to say. When pushed, I have obviously said that working with a leading technology company like Microsoft and them working more closely with ARM is obviously we're taking that as good news. But as far as that goes, I don't think we have anything further to add on Microsoft. So you won't get much more in the Q&A, I'm afraid.

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Back to the standard format of the presentation. You've seen this slide before, but here's an update on our licensing activity and how we're growing the licensing base. When you pull these numbers apart, you'll see a very good mix of new and existing customers, when you look at the earnings release in some detail.

We're pleased with the mix of products and also the mix of the type of licenses that are in here. Last year, during a bit of a semiconductor downturn, we did see a shift in the type of licenses that were done. And that was talked about and we explained that at our Analyst Day in 2009. And we talked at our Analyst Day a few months -- a couple of months ago about how that situation was changing. And that's reflected in this licensing that's happened.

A reminder of our new products for 2010 that align with the three different profiles. The applications profile, the real-time profile and the microcontroller profile in our architecture. So we have a third lead licensee signed up for Eagle. And, as I say, we'll launch that product fairly soon. Heron, which is the new real-time processor, we have lead licensees signed up there.

And the new one at the microcontroller end, we have already launched that product. It's called Cortex-M4. And it brings DSP capability to microcontrollers and the big announcement there in the quarter was with Freescale where they've announced a family of microcontrollers based on Cortex-M4. And there's a reminder of how the 29b-unit opportunity that we see in 2014 is broken down under those different product categories targeting the 29b-unit opportunity.

So that's the licensing. Just a reminder of the theory of how licensing leads on to royalty growth, the chart at the bottom left-hand side of the slide. This is our installed base of licenses. You'll see in the first half of 2010 it's ticked up again at about the normal rate, 34 licenses in the first half. So we're now over 690 licenses deployed in the field with the potential for generating royalty in future. And, as a reminder, the chart on the right-hand side shows that these licenses yield royalties over a very long period.

And our royalty revenue grows as we get new licensees starting to come to the ARM party, ship their first ARM-based chips. This quarter we're reporting five new shippers starting to ship ARM products. Or it could be when an existing customer starts to deploy ARM in a new division. And a couple of quarters ago we had a great example of that with ST. They're starting to get a lot closer to shipping ARM in their TV products.

ARM-based chips becoming a standard in new market sectors are another way for driving royalty growth. And certainly, the activity that we're seeing in microcontrollers is the great example of that happening as we speak.

And we're also seeing new types of customer adopting ARM technology, working more closely with ARM technology. And the announcement from Microsoft last week is a great example of that.

So that's the theory of licensing and driving royalty growth. How does that theory play out in practice for this quarter? You see the histogram at the top there. It says a couple of things. It says that our royalty is back to pre-downturn levels. It also highlights the fact that ARM is not immune to seasonality. And we're seeing effects of that in the Q1/Q2 transition that you can see on the histogram there, which is why we tend not to look at these things on a quarter-by-quarter basis.

If you look at things on a non-quarter-by-quarter, on a sort of yearly basis, you can see ARM's penetration coming through in increased royalty. Underlying royalties up 54% versus an industry up less than 40% in the corresponding period. And that's driven by unit shipments. Unit shipments are up to 1.4b units this quarter. That's nearly double where we were a year ago.

And it's right across the piece of ARM products. But we're seeing particularly strong growth now in the early stages of Cortex deployment. So Cortex products, that is across the whole of the different Cortex profiles, A, R and M, applications, real-time and microcontroller, up tenfold. So Cortex is now up to 6% of unit shipments.

And the point to note there is that Cortex A products, which we've been saying for some time, typically at a higher royalty percentage per chip. Those Cortex A products are just beginning to ship in volumes that start to move the dial. So that's encouraging.



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That said, for the quarter as a whole, we've seen very, very strong growth in things like Bluetooth, microcontrollers and other very low-cost devices, which is why the average royalty, when you look at that average royalty per chip, is down at \$0.045. This is actually good news. It's reflecting a very strong growth in applications like Bluetooth.

And just to note and remind everybody, on the chart there's a little asterisk there on the far right hand side reminding everyone that these Q2 royalties we're talking about are underlying royalties, ignoring the catch-up royalty that we reported during this period.

Those royalties are outperforming the industry growth, so there's a continuation of a chart that you've seen before with the ARM growth rate and the industry growth rate overlaid on top of the actual ARM royalties. And you can see the gap continues and in fact, widens in the current quarter. This is a reflection of ARM's growth in market share in the sectors in which we're already penetrated and a reflection of increasing penetration.

And you can see on the right-hand side of the slide, we've broken down in the usual way the key sectors that are driving that. Obviously the absolute numbers are very strong. They're strong because we're talking about gains on top of markets which are themselves growing very strongly on an annual basis compared with this time last year. But ARM numbers are actually growing more strongly in all cases than the underlying industry growth.

And I'll just highlight that that is even the case in mobile, where particularly we're getting used more in mobile phones. So the average number of microprocessors per mobile phone now up from 2.4 to 2.6 cores per phone. And Bluetooth is a big driver there.

So that's licensing and royalties. One of the ways in which, of course, we encourage licensing to turn into royalty revenue is providing the environment for our licensees to be successful. And one of the ways in which we do that is by investing in our ecosystem, and that's the general principle. We invest in this ecosystem, which creates this massive community of third-party developers around the ARM processors. That means that customers have a fantastic choice of associated technology that they can use when they're deploying ARM-based solutions. It also means that all those third-party developers are tied up working on the ARM architecture rather than other architectures. So that's why we invest in the ecosystem.

And in the quarter, we had a significant announcement at the beginning of June, when we kicked off the Linaro initiative. Linaro is a separate organization, which, for the time being, is controlled by ARM, but will disappear as a separate organization or disappear from ARM, I mean, become a separate organization. And that is all about optimizing the Linux kernel for ARM and producing optimized tools for ARM in the Linux world so that users can deploy Cortex-A class products from multiple silicon suppliers in an easy and straightforward way. So it's unifying that community out there.

It's also, as well as matching multiple SOC devices, it's working with the multiple Linux distributions that you see there, so Android, LiMo, MeeGo, ubuntu, webOS, etc., and making life easy for people developing Linux-based platforms.

Now our investment in the software ecosystem isn't just about Linux. Linux and the Linaro initiative was obviously the highlight of our quarter in this part of our business. But, as a reminder, we're investing right across the software ecosystem. So once again, a reminder on Microsoft, we've been doing that for a long time. Adobe Flash, widely developed in mobile computing and smartphones in the Internet world and Adobe Flash 10.1 on ARM is now shipping.

And just a reminder that it's not all about high-end application processors and mobile computing. At the microcontroller end we're also investing in software to make it easy for microcontroller users to deploy ARM-based microcontrollers with our CMSIS Cortex microcontroller software interface standard for Cortex-M based microcontrollers as well. That's also been happening. So right across the software ecosystem, some investment from ARM there.

And that investment goes on to help create ARM-powered products. And here's a reminder of some of the new ARM-powered products. At the top of the slide, you can see eBooks, TVs. Most of the Internet-connected TVs are now based on ARM. All Android



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announced TVs are based on ARM. And the majority of the tablets, even some of the netbooks, you can see netbooks there, are based on ARM. By 2014 we expect 3b of these screens in the Internet-connected screen area. By that time we expect at least 75% of them to be based on ARM.

In fact, behind those Internet-connected screens are the infrastructure, real-time products with real-time processors. So most of hard disk drives are based on ARM today. Nearly all the baseband modems that you see out there allowing these things to communicate, half the WiFi processors are based on ARM. And by 2014, we estimate the total to be about 10b devices with real-time processors and we expect that a great number of these will be based on ARM.

And at the embedded end, this is where microcontrollers are typically deployed, we're seeing huge numbers of design wins today, with companies increasingly adopting the ARM architecture for these types of products, from things like smart meters to cars, to motor control in washing machines and those sorts of things. It's a huge growth opportunity for ARM, and that's a reminder of the sort of activity that we're doing in terms of driving design wins which is what ultimately drives royalty.

Now I'm going to change gears and switch to Physical IP. It was a great quarter for our physical IP business in terms of activity with leading-edge customers and really influential customers. We sold three new platform licenses during the quarter, not all at leading-edge platforms, but we sold at 130 nanometers as well. And in fact these older technologies will live for many, many years, because it's very economical for people to build products on some of those older technologies. And those mature nodes are actually quite good for us in terms of profitability as well because we have increasing re-use. And so the licensing activity that we do there is inherently more profitable.

Early this quarter, though lots of the activity took place last quarter and actually in quarters before, we announced a license with TSMC at advanced nodes, at 28 nanometers and also 20 nanometers. And so at the 28-nanometer node we are now working with TSMC in our physical IP division for both low-power and high-performance process variants. And that really completes the set of key semiconductor foundries for the 28- and 32-nanometer nodes. So now if you're a customer and you want to work at those nodes, you can use ARM's physical IP and you can go and get your devices made with any of the leading foundries in the world.

So we're very pleased to see TSMC come to that party with ARM. We're even more pleased to see them sign up with us for collaboration on 20-nanometer technology as well, and again both the low-power and high-performance variants. So physical IP customer activity is in pretty good shape.

In terms of perhaps a backward-looking indicator in some ways, our Q2 royalty in physical IP, underlying royalties up hugely with the rising market, of course, on the year before, if we strip out the catch-up.

So a bit of context on the physical IP development. You've seen a variant on this slide several times before. So here we are updating it for the middle of 2010. It's basically saying that our leading-edge technology is on track. At the right-hand side of the slide, we're pushing our R&D towards 20 nanometers. 32-nanometer common platform technology is all now available. And tape-outs are happening. We're actually seeing our very, very first 32-nanometer royalties coming through from the very, very first customers. But in terms of much wider deployment, it's out there and ready for design wins right now which will generate royalties in a few years. And, as I said on the previous slide, TSMC has now come to that party at the far right-hand side of the slide. So that program is very much on track.

Stepping back and looking at how our physical IP business is developing and will develop, it's about growing market share. The histogram on the top of the slide shows that we are, little by little, growing our market share. This is an analysis of the number of wafers, or 200-millimeter equivalent wafers at any rate, and those wafers which deploy ARM physical IP. And so you can see that over a period of a few years, that's iterating upwards. We're growing market share.



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But we're growing market share of a market which is growing hugely. And we expect over the next five years, as IDMs around the world seek to outsource their silicon production more, we expect the foundry market to grow substantially. So we're gaining share in a market which is itself growing substantially.

And then when you peel back another layer and look at the histogram at the bottom of the slide, and look at where that growth is driven from, you can see superior growth at the leading-edge nodes. And it's those leading-edge nodes where ARM now has a full house in terms of physical IP technology deployed across the leading foundries. So that's really what's going to drive our Physical IP business over the next several years.

So let me summarize. It's a great quarter. There's a lot happening. And the results reflect progress in all parts of our business. And we're very pleased to see influential market leaders coming to ARM and three significant announcements over the last couple of weeks.

We've talked about markets with long-term structural growth, mobile devices, digital TVs through the connected Internet, disk drives, because the Internet means lots of data and people love storing the data, and microcontrollers as intelligence gets deployed more and more widely in the products around us in our everyday lives. So ARM gaining share again in all of those areas.

At our Analyst Day I said we have the best business model, technology and ecosystem for now. We absolutely do. These results are showing that, showing us outperforming the industry, with our royalty up over 50% versus an industry growing in the 30s. And that's driving a superior profitability, cash generation so that we can increase the dividends and, at the same time, invest in R&D to drive that ecosystem and our product portfolio for the future.

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

Tim Score - ARM Holdings plc - CFO

Morning. So the good news is, well, very good news, I'm not going to say anything about that. But there's even better news. I've got three slides. So let's get through them quite quickly because I think you've got a lot of information in your packs and you're dying to get on to the questions. And we'll see what they relate to.

So, as Warren said, and Warren has covered quite a lot of the detail here, so I'm going to go through it pretty quickly. It was a good -- a strong licensing quarter, not just for revenue. 36.6m processor was a good recovery from the lower levels we saw in 2009. I think probably more importantly, from our standpoint looking forward, is that there were several licenses that occurred, that built backlog in the quarter. The Microsoft deal which we've touched on, Warren referred to a handful of other A class processor licenses, which helped backlog as well as short-term revenue, and the Eagle license which predominantly is a backlog builder.

And what that's meant is that we're up more than 20% sequentially and about 50% higher than we were a year ago. And we'll come on to what that means for the outlook a little bit later.

I think we touched on royalty. You may know that's the first time that we've reported catch-up royalty in the Processor division since Q1 2006. So this is a rare event. It doesn't in any way undermine my confidence in the general ability of our licensees to pay us royalty on time. I think this genuinely is a one-off event, where predominantly one particular part which [shipped] for multiple quarters for about three years, got missed off and was identified in preparation for one of our normal audits. So I wouldn't expect to see anything like this very often at all. But it obviously did affect the numbers. So we'd like to make very clear that that was effectively a one-off.



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On the cost side, Q2 OpEx, a shade over GBP52m. Consensus was about GBP51.3m. And about half of that difference is a translation issue. Consensus was about \$1.52. The actual cost rate for Q2 was about \$1.49. That makes up about half the difference. The balance of it -- obviously we're talking about small numbers ins and outs, but the incentive payments are running a little bit higher as the revenue and bookings trajectories being at an elevated level. So there's a little bit more bonus-type accrual in there as well.

I think for the next quarter, as we say in the release, presuming the FX is around similar level, somewhere in the GBP53m to GBP55m range for OpEx. And I think if the currency stayed at where it is right now, at around \$1.54, \$1.55, we'll probably be at the lower end of that range.

So what of course, this has been yielding is margin expansion, but not at the cost of lack of investment. Obviously we've been managing, as Warren said, the cost base pretty carefully during the downturn. Headcount has been relatively flat. We said we're going to grow it this year, that's what we're doing. It's up 65 at the half year and it'll be up again at the end of the year. By how much, we will see. We obviously need to get the right people into the organization and the pace of recruiting them will, to some degree, relate to what's going on outside in the big, wide world.

But this margin expansion, 39% in Q2, if you strip out the catch-up royalty, is still much higher than we've seen prior to coming into this year. And this has been throwing off a lot of cash. The net cash is about 3 times the level in the first half than it was last year.

And having increased the dividend by 10% for the last two years, so through the downturn, we're now increasing the interim by 20%, which is more a reflection of how we see earnings growth developing over multiple periods, rather than obviously what's going to happen in the balance year of 2010, where current consensus has our earnings growing at north of 50%.

This is the slide that usually sits in the back. But I thought I'd just bring it forward. What we -- and I think here, when you're thinking about licensing going forward, looking at the maturity profile is quite interesting. The revenue to be recognized over the next couple of quarters is a little bit lower than when you saw this last time. But it's actually off a much higher number. So the absolute coverage of target license revenue already in backlog is higher.

And when we look out into the second half of the year and look at the mix of licenses that sit in the opportunity pipeline, that gives us quite a high degree of confidence that, for 2011, the coverage of target license revenue that will sit in backlog at the end of this year will be higher than we normally enjoy, which I think is an encouraging sign. We're obviously way -- in a sense way out, but it's an encouraging sign as we look forward into 2011.

So again, just to wrap up before questions, we're continuing to execute the strategy. Clearly, broadening adoption visible in royalties and visible in licensing agreements. And market share gains in all of our target markets.

I think we're very well positioned for the second half. We have a record order backlog, which is good for short-term revenue. It's also good for long-term recurring revenue. The opportunity pipeline, as I say, is pretty robust, and there's a good mix of deals, which are going to yield revenue in the second half and yield backlog for 2011. And we see no reason why the market share gains that we've been enjoying in royalties do not continue.

We say in the outlook, as we've said in recent outlooks, that we still see uncertainty in the macro environment. And I think it would be remiss not to remind ourselves of, I guess at the very best you could say currently mixed messages that are out there. But who knows how the austerity packages are going to play into consumer demand and the global economy over the next few quarters. And I think we've just flagged that. Now whether that has an impact on ARM in 2010, early in 2011 or not at all, we will see. But it would seem to us to be careless to assume we could be immune from what may be coming down the road in that regard.



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And as I said on the -- and some of you picked up, I said on the wires call this morning, that it's possible this could manifest itself in a lower seasonal uptick going into Q4. But that's -- given how much guidance we've seen for Q3 from our shipments, that's largely a theoretical comment. There are one or two who have guided already sub-seasonal. But whether that will be enough to impact -- normally you'll note that ARM's royalties are often up somewhere between \$5m and \$10m Q3 into Q4.

That might happen, it might not. As you know there's not a lot we can do about it, other than report it. But we're just flagging the notion that it seems to me that that could be a possibility. Maybe it's more likely to impact at the beginning of next year rather than the end of this given that we're a quarter in arrears. But we will see.

I think in terms of licensing, almost irrespective of what happens in the macro environment, I don't really see any material impact on the licensing behavior between now and the end of the year frankly, given the backlog, given the pipeline. So I think the licensing outlook is pretty encouraging.

And lastly, I guess some of you will recognize the tone, if not the wording, of that guidance. The slight complexity this time is we wanted to stress that we are confirming current consensus effectively plus 9, not current consensus including 9. If it was including 9 some of you would assume that we were downscaling our guidance, which we're not. Whether we will, as we have done in recent multiple quarters, do better than that, only time will tell. But that's what we're confirming today.

Thank you. Didier's hand's up first.

QUESTIONS AND ANSWERS

Didier Scemama - *RBS - Analyst*

Morning gents. A couple of questions. First of all looking at the licensing, the licensing outlook, a couple of questions on that. First of all, have you started recognizing revenues from the Microsoft license in Q2 or that's coming up in the second half?

And second, we've seen over the last three years, a number of non-traditional semiconductor companies, non-traditional customers out there who are licensing ARM. Microsoft is another company I have in mind. Is there any reason why other software companies that may have made some kind of investment in recent months may also be interested in picking up architectural license?

And the second question is on Mali. Can you just frame a little bit Mali opportunity in terms of royalty rate with regards to GPU and the video processing IP as it is combined with a CPU, say? How much royalty percentage would you get if you get the three IP box? Thanks.

Tim Score - *ARM Holdings plc - CFO*

The first question is there's no revenue in Q2 from Microsoft. We would expect to start recognizing that revenue, which will be on a subscription accounting basis, over the life of the arrangement, probably in Q4.

Warren East - *ARM Holdings plc - CEO*

Okay. And the other two questions, it's an interesting question about the non-traditional companies who have licensed ARM. Whilst we sell licenses primarily to semiconductor companies, we work with, at a technical level, a number of other companies, either in the ecosystem; companies like Microsoft that are providing complementary technology to somebody who's building a product, or with somebody who's like an OEM who's actually building a product. And in some instances those companies will feel that they can do something a little bit special if they have a little bit more control over the implementation of the

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microprocessor. And so, under those circumstances, we enter into discussion about how they could work more closely with ARM. And in a very few instances those discussions head off in the direction of an architecture license. And that has happened in this case.

It's by no means a normal thing. And an architecture license, if you're going to deploy it effectively, you still need access to a very good microprocessor implementation team. And we'd like to think that we have some very good microprocessor implementation teams. And so the chances are that we can do something very good for you as well. But we stick to our road map and other people sometimes want to do something a little bit different. And our goal is to enable all the players. And that's why we have flexible licensing models and we're prepared to enter into those sorts of agreements.

We're very, very strict about maintaining compatibility of the ARM architecture. So you write a bit of software for an ARM 7 TDMI in 1996 and it will run on a Cortex A8. It will run on a Cortex A9. It will run on an architecture-licensed product from any one of our architecture licensees out in the future.

Mali royalties are broadly similar to general-purpose microprocessor royalties. If we pull Mali out, it's a different type of processor. The video processor's a different type of processor again. And it makes engineering sense to have a different type of processor to implement those functions. From a commercial point of view, it looks exactly like an ordinary ARM microprocessor. And if you have multiple ARM microprocessors on a single piece of silicon then we enjoy multiple royalties.

So I think we have to move on. Sandee?

Sandeep Deshpande - JPMorgan - Analyst

Hi. A couple of questions. The first question I have is again on architectural licenses. Is there any correlation between architectural licensees and the volumes they ship, because historically you have signed a lot of architectural licenses -- I mean, not a lot -- a handful of architectural licenses? And they really haven't really contributed -- most of those companies who have signed architectural licenses haven't very much contributed to your royalty unit. Mostly your own processors have done better than the architectural licensees. That's the first point.

The second question I have is on the PIPD business. PIPD, clearly on the licensing front you seem to be showing some progress there. But on the royalty front, if you look at TSMC's revenue in the first quarter, it actually was flattish to slightly up versus the fourth quarter, versus your royalty revenues were down by a few percentage points or more in PIPD. So what is that reflecting on the PIPD royalty units? What is exactly happening, given that you're talking about the market share gain?

And finally there's been lots of speculation, which you have addressed before, about acquisition of ARM, etc. What protection do ARM licensees have in the event of an acquisition of ARM, given that they are basing their own road maps on the back of ARM? So if, for instance, ARM was not able to provide them with IP in the future, what happens to those licensees?

Warren East - ARM Holdings plc - CEO

So let's deal with that. So architecture licensees and their contribution to ARM's royalty, there is no correlation between architecture licensees and high volume. The architecture license, as I say, is for somebody who wants to build a microprocessor. They [believe] in their implementation they can in some way do something different. I say different, not necessarily better, different from the standard ARM implementation.

Now we target our implementations at a wide range of semiconductor companies and their requirements. Some people believe they want something a little bit more special. That's what the architecture license is for. Whether or not they derive significantly more volume from that is a question you have to talk to them about, the economics of their business. We earn the same royalty

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per chip, whether it's an architecture licensee or whether it's an implementation licensee. And we're interested in enabling our partners to do what they want with the ARM architecture.

Tim Score - ARM Holdings plc - CFO

Yes, most of our architecture licenses -- architecture licensees typically take implementation licenses as well. So they often take an architecture license as an option for a particular product in a particular market. But alongside that they're also licensing our own implementations. So again it's -- in fact in terms of the ultimate royalties it's -- I wouldn't say there's a correlation.

Warren East - ARM Holdings plc - CEO

PIPD royalty, which was your other question, and for those of you in the room who perhaps -- so I'd like to repeat the question. The point was that if you look at TSMC revenues on a sequential basis, they increased. And we talked about gaining market share. And actually our physical IP underlying royalty didn't increase as much as TSMC's royalty.

And this is simply because we have a market share at the moment, as we put on the slide, it's about 20% of the number of wafers. Most of the wafers are generated by the big shippers, the Qualcomms of this world, who deploy their own physical IP at the moment. And TSMC enjoyed a large growth in the period on the basis of those types of customers where ARM's physical IP is currently not deployed. So I think it's an artifact of that arithmetic and nothing more.

In the non-Qualcomm-type portion of foundry business, as shown in the histograms, we're increasing our market share.

Sandeep Deshpande - JPMorgan - Analyst

Are you gaining share within the Qualcomms and Broadcoms which currently haven't [seen] licenses?

Warren East - ARM Holdings plc - CEO

Well, as and when we have an announcement to make with a company like Qualcomm, then I think we'll seek to make it.

The other question was a bit more academic, really, about acquisition. We're a public company. And consequently if somebody wants to buy ARM enough, then that's what they'll do. We believe that it's in the best interest of our customers and shareholders for ARM to be independent. We are explaining to you how we're exposed to areas of big structural growth. And ARM's prospects as an independent company are very, very positive.

Do customers have -- Tim's just reminded me your question is do they have protection. Customers, particularly in the light of recent rumors, asked us the question. And if you have an ARM license, typically it's a perpetual license. As long as you continue to pay royalties, you can continue to do design with those products.

Future road maps, we're working on future road maps. Those customers that have architecture licenses can do what they want with them. So there is an element of built-in protection anyway.

Nick? We're working from front to back down that side of the room at the moment.

Nick Hyslop - RBC Capital Markets - Analyst

I have two questions. Could you -- the PD catch up, I wonder if you could expand a bit on how that came about. \$9m seems quite a big miss or misunderstanding with one of your customers over a number of quarters. I'm wondering, having had that

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misunderstanding, whether you feel there might be scope for a few other misunderstandings amongst some of your other customers on royalties. That's the first question.

Tim Score - *ARM Holdings plc - CFO*

Well, as I said when I was on the podium there, that was the first material -- that's the first processor royalty catch-up we've had to report since Q1 '06. And there wasn't any before that either. So effectively it's happened twice. In this particular case it was just one very high-volume part that was, for whatever reason, systematic, didn't find its way into the royalty reporting. That can happen. These customers are building multiple ARM-based devices and in this case it was missed. And it's very, very unusual.

So I don't -- as I say, I don't think it says anything structural. But we continue to have our ongoing cyclical royalty audit program. We use all the big four and they're basically surfing around the world all the time doing these audits. And this \$9m was identified by the customer, not the auditors.

Nick Hyslop - *RBC Capital Markets - Analyst*

You needed to have an extra review?

Tim Score - *ARM Holdings plc - CFO*

It was identified by the customer in advance of an audit which is now taking place. Okay.

Nick Hyslop - *RBC Capital Markets - Analyst*

I'm sorry but the second question, unrelated, you talked about yourselves being happy with consensus for 2010, for the current year. Perhaps you could let us know what you think consensus is for 2010?

Tim Score - *ARM Holdings plc - CFO*

Before today, or today, it's GBP584m. And what we're saying in here is we assume the \$9m will be added. And then you'll do what you do when you look at the result against what you had in Q2 and what we're saying about Q3 and Q4. So I wouldn't be at all surprised if it doesn't do what it's done in recent quarters, which is edge up.

Unidentified Audience Member

I just had a follow-up question about PIPD. A lot of the volume obviously at some point will come on the 3X node, I suspect, from your customers. But what -- how should investors measure the portion that you actually address? It's very difficult for us to see as to how many programs would be done on libraries that the foundries are using themselves and how much of that wafer output is based on yours. How should we get a better understanding of that?

Warren East - *ARM Holdings plc - CEO*

Well, we're going to have to work on that from a presentation point of view. I agree; it's difficult to separate out that which is addressable market and that which is not really, practically addressable. Ultimately we think it is pretty much all addressable. And so we don't really see any structural barriers to that 20% continuing to increase.

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And the picture that we were trying to paint was that a lot of the 80%, at the moment, is captive in-house. A lot of it is historic process nodes. We are signing platforms at some of the older, more mature nodes. But we're concentrating our efforts, as indeed we have been talking about for the last several years, we've been concentrating our efforts leading edge, so that when the market eventually migrates to that leading edge, we have it completely covered and a much larger proportion becomes addressable.

But I appreciate that it's difficult to separate out those two chunks. And you could make some approximations how much is the top five, 10 fables players who typically use in-house. And you could make a first approximation excluding those and then look at our share in the remainder and look at how our share tracks in the remainder. But, as I say, long term, I'm not for separating them. I see it all as opportunity.

Unidentified Audience Member

Okay. My second question is just on the balance sheet. I ask this every quarter for the last couple of quarters. Net cash up 3x, so as a percentage of your overall capitalization, it's in the same situation that we had in 2001. And eventually, of course, it led to a rather large acquisition. So I was wondering how you felt about the balance sheet today, how much room there really is to redeploy more. I appreciate you've taken up the dividend already, but what are the other avenues, say?

Tim Score - ARM Holdings plc - CFO

Well I -- your memory of the 2001 balance sheet is probably better than mine. But right now we have GBP200m net cash. And you guys know what the market cap is. So in that sense it's not a sort of an egregious amount of cash burning a hole in our pocket.

Having said that, we have a history of doing bolt-on acquisitions. I accept that we did a major one at the end of 2004. But that, the size of that I think showed you it was nothing to do -- there was no sort of in-advance building of a cash balance so we could do it. It was something that we felt was strategically right for the long term.

So the plan on record is a progressive dividend policy. You've seen us do other things. We've returned GBP370m of cash by buyback between '05 and '08. The buyback remains available to us. So, yes, I think, over time, it's highly likely that there are going to be other capital structure management issues to be communicated to you in addition to the dividend. But we don't see a pressing need to materially reduce the cash that we currently have.

Gareth Jenkins - UBS - Analyst

Thanks. Gareth Jenkins, UBS. A couple if I could. I just wondered, you mentioned last quarter about integration being effectively accretive to your business model. And I just wondered whether you're seeing the first signs of that sort of accretion coming through.

Secondly is just on Eagle, the announcement some sort of three lead licensees. I just wondered in which area those licenses are looking to roll? Is it smartphones, mobile computing? Which are the specific areas?

And then finally, it's a kind of more holistic one, just from the chart you put up about PD royalties against the industry growth. You've seen that spread widen, so your rate of pace of market share increasing against the industry. And I just wonder how you see that playing out over the next 12 to 18 months. Do you see your market share gains accelerating from here, given all the licensing activity we've seen, or just keeping pace basically?



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Warren East - ARM Holdings plc - CEO

Right. Three very different questions. I think, by the integration and the accretive nature of integration, you're referring to multiple ARM processors on a chip eventually leading to more royalties from that chip than when there are two chips. As per our Analyst Day presentation, we've shown you the mechanics of how that works. I think it is too complex to read much of that happening into these numbers right now.

It's an interesting question that I'm sorry I'm just not prepared with a canned answer for, other than what we showed you at the Analyst Day. Maybe we can have a think about trying to look for some examples of that and try to draw out how it is contributing. I'm looking at Ian as I'm saying that and we have thumbs up from Ian in the back of the room. So all right we'll have a look at that for you before the next time.

Where is Eagle going to be used? Well Eagle is a high-performance A class processor. There's no reason why Eagle can't be used in a mobile computer or some other computing platform. Probably the first deployments though will be in high-end smartphones. The first deployments will not be pushing the top end frequency of Eagle. They will be aiming very much at the power envelope of smartphones. And that's where you'll see -- so it's more capability per performance, but fundamentally it's more efficiency. And that's the first ones.

And then PD royalties versus the industry, well, we're painting a picture of exposure to structural growth markets, things like digital TV. Things like microcontrollers which, in and of themselves, are sectors which are set for superior growth to the bulk of the market over the next 18 months to three/four years. And you can see, within those sectors, ARM is very heavily exposed. And so right now I would say you might see a modest acceleration.

Unidentified Audience Member

Thanks. I just have two questions. First was on gross margins, which seem have been coming in a little bit ahead of expectations. If you could give some guidance as to where those are going forward?

And secondly just again on Mali. If you could just give us an update on the kind of run rate and your volumes for Mali today, and what are the material segments where volumes are coming from at this time?

Tim Score - ARM Holdings plc - CFO

Yes. I think the last time I stood up here I gave a slide that broke down the component parts of gross margin, in the context of painting a picture that it is going to increase over time. And really there are a few variables. But by far the overriding one is what is the proportion of royalty revenue as a total of the whole. Because royalty revenue is a 100% margin business it's essentially that that's driving up the gross margin. But I think, when you're modeling out forward, then something around these current levels is the way to think about it.

The headline number this quarter will be somewhat flattened by the catch-up. So it's not quite as elevated. But it's certainly operating -- and I think I said, in a fairly mealy mouthed way six months ago, that it's more likely to be north of 93 than south going forward. And I think that's still a good way to think about it.

Warren East - ARM Holdings plc - CEO

Okay, on Mali and volume [shipped]. Right now Mali is not really moving the dial in terms of the royalties that you see on a quarterly basis. It's been very much a story of licensing and design-ins. Typically these chips are two to four years from licensing to royalty. We kicked off with Mali at the back end of 2006. Therefore we'd expect to see royalties starting to happen around about now. And we expect that.

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First -- there are shipments happening in smartphones. And that's where you are going to see the shipments predominantly. There's a little bit of design-in also in digital TVs and you will see some more of that. And ST talked about that at the back end of last year. So I think if you look at apps processors in smartphones and apps processors in digital television, that's the target market. And we see our share in that growing as further licensing that's been done over the last few years. There will be a significant portion of those that will switch to Mali.

And then we have a question at the front.

Unidentified Audience Member

I seem to remember, I may recollect incorrectly, that a year or two ago you gave like a 50m-unit run rate for Mali as the numbers being shipped. I don't know if that's right or wrong?

Warren East - ARM Holdings plc - CEO

Did we? 50m units?

Tim Score - ARM Holdings plc - CFO

It wouldn't have been for Mali. Obviously we have some legacy shipments of --.

Warren East - ARM Holdings plc - CEO

(Inaudible).

Tim Score - ARM Holdings plc - CFO

Yes. But Mali, we only acquired Mali right at the back end of '06.

Warren East - ARM Holdings plc - CEO

Yes. I think maybe a couple of years ago we would have been talking about graphics processors, and probably smartphone volumes at that time were about 50m units. And that's probably where the number was coming from. That remains the target market, that and the apps processors in digital TVs.

As we look forward that 50m has grown, apps processors in smartphones, to several hundreds of millions today on a per-annum basis. And Mali will take a share over the coming years. Again it's an interesting question that we should probably, as and when Mali starts shipping, then we should look to a little more disclosure on that. But right now it's so immaterial to our royalties that it complicates things to talk about it.

We do have a question at the front.

Unidentified Audience Member

Morning. The question's about the Linaro-related charges. You said that about GBP4.5m investments over the first 12 months. That's roughly the current run rate - from Q2. Two questions. One, is that essentially just covering the running costs of the

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operation as it's set up? And B, what happens after that? Are you expecting the same sort of rate of investment, or do you some inject some capital and let it loose?

Tim Score - ARM Holdings plc - CFO

In these Q2 results you see GBP1.3m cost incurred. Most of that is actually one-off launch costs of getting this entity into play. Some of it is the very initial, because this was launched on the June 3, very initial running costs of the entity which, as Warren said, is actually currently, on a temporary basis, owned by ARM. And because of that it's pulled out separately.

In terms of once that organization is settled down, what ARM's ongoing contribution to it will be will depend on the number of contributing participants when that settles down. What we're disclosing in here is what we expect the cost to be in the first 12 months from June to June. But I think probably back end of this year, very early next, I'll be able to update you more. In all probability we would have lost control of the entity so it will no longer be a subsidiary, and what the ongoing ARM commitment is likely to be.

Brett Simpson - Arete - Analyst

Thanks. Brett Simpson, Arete. So I had a question on the mobile royalty business and the unit assumptions you're using. If we just look at the quarter, you said 1.4b cores and 62% were mobile. And in the cores [pro forma] 2.6. So that backs out at about 235m handsets is your assumption for Q1 shipments globally for handsets. My question is how do you account for grey market players? So we talked to Media Tech and they are publicly saying that they are going to ship 0.5b units this year, spread from MStar, all these players that are your licensees. Are they included in your unit assumptions, if you could just clarify that?

Well, Ian, behind you, is going to tell you how he came up with the number.

Ian Drew - ARM Holdings plc - EVP Marketing

So the formula I use, I take what's reported by customers and then I use the -- traditionally use the Gartner mobile phone numbers and have done for a number of years. So as those evolve to better include the China numbers, then maybe we'll get a better representation. But at the moment I just want to be using a standard set of numbers and be consistent to the numbers that I'm using.

Brett Simpson - Arete - Analyst

Thanks.

Kai Korschelt - Deutsche Bank - Analyst

Hi it's Kai Korschelt from Deutsche Bank. Just a quick question on OpEx. I think your Q3 guidance is pretty clear. But on Q4, as we assume that consensus revenue estimates are met, should we think about a sort of sequential increase again in Q4 in OpEx or a stable-ish run rate? Thank you.

Tim Score - ARM Holdings plc - CFO

I think I mentioned when we did the last results, it's likely to just gradually jump, which is what the consensus -- coming into these results, consensus was GBP53.3m for Q3 and GBP54.3m for Q4. And that feels fairly sensible. We were in a net

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investment-in-people mode. And it's gradual. So I think that's probably as good a shape of the OpEx as I would guide you to at the moment.

Andrew Gardiner - *Barclays Capital - Analyst*

Good morning. Andrew Gardiner from Barclays. Just a couple of clarifying questions. First on the auditing of the royalties. Can you tell us how often you're auditing the customers? Some of these seem to be extending back a fair way. You mentioned 2007 to 2010 as the overall period. So I was just wondering whether this had been missed in one of the prior audits or not.

And also in terms of the backlog, you'd announced the Microsoft deal last night, but you seem to be indicating -- sorry, last week. But you seem to be indicating that that's in the 2Q backlog. Is the TSMC deal also in the 2Q backlog or is that going to drive 3Q up yet again? Thanks.

Tim Score - *ARM Holdings plc - CFO*

Every three years broadly. And no, and yes.

Janardan Menon - *Liberum Capital - Analyst*

Hi. It's Janardan Menon from Liberum Capital. There was an announcement, I think it was yesterday or today morning, from an automobile manufacturer consortium, I think it's called LBI or something like that. I'm not too sure. But it consists of all the major automotive companies and the component suppliers. And they've basically announced that they have chosen MeeGo as their operating system of choice for all in-car telematics, which includes GPS, entertainment, etc. And you guys have invested in Linaro to try and push ARM implementation on Linux versions.

And my question is, looking forward, when you talk about these kind of devices which is non-mainstream mobile phone kind of, so you're going into automotive, television, etc., is the choice of microprocessor going to be more based on the choice of operating system, which is, is the operating system taking preference over the microprocessor, or will the microprocessor be chosen on its own merits? And I completely grant that you will see MeeGo implementations on ARM cores. I don't dispute that for a minute. But generally one would assume that the majority of MeeGo implementations will be on Intel processors rather than on ARM processors.

Second question is just on PIPD, just a clarification. Your market share has been running at about 18%, 20%, as your chart suggested. But I thought I saw something saying that only 15% of your royalties is sub 90-nanometer, something like that. So now that you've caught up and you've got a lot of leading-edge process nodes going, does that automatically lead to a rise in market share in PIPD? Or are we back to waiting for Qualcomm and those types to sign up? Are they both -- is that a mutually exclusive decision or does your existing customer base itself give you a big leg up on the back of these leading edge processors?

Warren East - *ARM Holdings plc - CEO*

Okay. First question, MeeGo and the automotive announcement. MeeGo happens to be a Linux stack in which Intel has put their weight behind. All the first implementations of MeeGo will be ARM-based. I suspect, in volume terms, the highest volumes of products running MeeGo will be ARM for quite some years to come.

And so I think the question was about microprocessors and operating system. If you look to the user, the user doesn't care what microprocessor's in there. The user, the operating system is very much about that. Now we don't know whether MeeGo is going to win in the Linux world or whether it's going to be Android or LiMo or ubuntu or any of them. What we do know we want to do is enable most of those to be ARM-powered so that the people who are building the product, who are the ones that do care

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about the microprocessor, have the simplest, least-resistant, lowest-cost route to developing their product around the ARM microprocessor.

And that is what Linaro is all about. It's about optimizing the Linux kernel and the tools for the range of ARM-based system on-chip devices so that those people building the products are not limited in any way when they choose one of the several Linux operating system distributions. And some of those people will choose MeeGo, and we hope they'll be very successful with their MeeGo-based products running on ARM microprocessors.

For PIPD royalty growth, then it's true that the volumes from the leading-edge products at the moment are very small. We've concentrated on the leading edge. And so certainly we're opening up the potential for significant growth. And what I tried to show in the presentation, with the enhanced growth in the foundry space coming from those leading-edge processors, is how ARM is exposed to those high growth areas within the foundry business for physical IP.

In terms of design wins with companies like Qualcomm and like Broadcom, they can only accelerate that growth if and when those companies decide to use ARM physical IP. And obviously we're working with them to try to bring that day forward.

I think we're running out of questions, so I'll just have the last one or maybe two, if there are any. Excellent.

Well, thank you very much, everybody. And we'll see you again in early February. Well, I'm sure we'll see many of you before that. Thank you very much.

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