FINAL TRANSCRIPT

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PRESENTATION

Ian Thornton - *ARM Holdings plc - VP IR*

Good morning. Thank you. This is Ian Thornton, Vice President of Investor Relations at ARM. On today's Q3 results conference call we have Warren East, Chief Executive Officer, and Tim Score, Chief Financial Officer. On today's call Warren and Tim will take us through the highlights and comments from the quarter's results and then we'll open the call up to a Q&A session. As a reminder, the presentation and press release can be found on the ARM Investor Relations website at www.arm.com/ir.

Before I hand over to them, I just have to read out a few words with respect to this conference call and what we're about to discuss. The contents of this conference call are being directed only to those of you who have professional experience in matters relating to investments and the information communicated on this call is being made available only to investment professionals. Any persons present on this call who does not have professional experience in matters relating to investment should not act or rely on the contents of this call.

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

And on this note, I'll hand over to Warren.

Warren East - *ARM Holdings plc - CEO*

Thanks Ian. Good morning, everybody, and thank you for joining our Q3 results conference call. So, as usual, I'm going to run through some highlights and then hand over to Tim. And I hope we'll cover most of the content in Q&A.

A quick introduction. We are benefiting from growth in markets where we already lead at the moment, such as mobile, where smartphones and mobile computers, like tablets, are growing very strongly. We're also increasing our penetration in other growth applications, like storage, digital TVs and microcontrollers. And, on top of this, our partners have begun experimenting in new areas which offer future growth opportunity, things like servers and even laptops.

Now Q3 is traditionally a challenging quarter for us, with holidays happening on both sides of the Atlantic. But this year the semiconductor industry has been quite buoyant, and that buoyancy has continued with licensing very strong across the ARM business, leaving what was a record backlog at the half-year some 10% higher by the end of September.

Our market share gains have continued to drive the royalties to outperform the wider industry. ARM's royalty was up 33% year on year, versus the industry up about 25% in the corresponding period. So today we're reporting record quarterly revenues by a considerable margin.

And, as we indicated at the half-year, we've continued to invest in the strategic areas of our business by growing our headcount. That's mainly in the design teams in the Processor division. And that reflects our confidence in the medium-term demand for our technology, right across all the key market sectors that we're targeting for growth.

You may recall the quarter began with the conclusion of what is really a milestone agreement with TSMC in August. And then later in August our Annual Partner Meeting saw record numbers attending to discuss future technologies.

And in September we launched the latest flagship ARM processor, the Cortex-A15. And this is delivering some five times the performance of a Cortex-A8 in a similar power envelope. The processor is aimed at high-end smartphones and mobile computing devices of 2013 and beyond. And it also opens the way to new application areas for ARM, like servers to support cloud computing. We've got three lead licensees signed up for that already and it will become available for licensing by the rest of the partnership in the first part of next year.

Now just a little on the detail of the different parts of the business. I'll start with the Processor division, where reported license revenue was $42m; that's up 37% during the quarter. And we signed 22 licenses; that's 56 year to date, bringing the total license base up to 716. And of the 22 licenses sold, four were initially targeted at mobile applications, which means that our efforts to push into non-mobile applications are enjoying great momentum at the moment.

So of the 16 Cortex licenses sold, five of them were for Cortex-A9 and 10 for Cortex-M products. And the target applications there include digital TVs, cameras, printers and servers, as well as a host of microcontrollers used in all sorts of applications, including sensors, automotive and in both energy generation and usage. We also sold two further Mali graphics licenses and, in addition, one major semiconductor company became an architecture licensee with plans to target the server market.

Looking at our royalties, remember ARM's royalties are reported one quarter in arrears, our royalty for Q3 was up 33% overall at $70m. The total volume was a record, 1.5b units. And that was driven by continued growth and increasing sophistication in smartphones and also continued strong growth in microcontrollers. And we've got a more complete breakdown of volume shipments in our earnings release.

If we look at that segmental analysis, what it's showing is continued gains in market share in non-mobile applications. MCU design wins, microcontroller design wins included energy-related applications, like solar panels and smart metering. And for ARM microcontrollers, the rise was 65% versus an overall market rise for microcontrollers of 50%.

And if we look at storage, ARM's 50% versus 20% overall. And in DTVs, ARM's 40% versus 20% growth overall. And in mobile, and some tablet and mobile computer design wins were announced, the average number of ARM processors per phone is now up to 2.7 ARMs per phone. And that means that it's driving ARM out-performance in the mobile sector as well. And one final point to note on the volumes, Cortex products are now collectively accounting for 9% of the total volume.

Now I'll switch to our Physical IP division, where revenue was up 21% overall at just a shade under $22m. And that was helped by a record underlying royalty of $10.7m. Three new platform licenses were signed in the quarter including the significant agreement with TSMC. That's a total of 76 Physical IP platform licenses driving long-term royalty revenue.

And to meet the increasing demand for Physical IP use with our advanced Cortex-A series processors, we've created packages of optimized Physical IP that allow the user to implement a processor with predetermined performance and power. And they're proving to be very popular with our licensees, with companies looking to create very high-performance low-power chips. During the quarter we signed three licenses for Cortex-A9 processor optimization packages, at 32 nanometers and at 40-nanometer nodes. And that's for use in digital TVs, networking infrastructure and server applications.

If we look at advanced processors, that's 65 nanometers and smaller, now these processors are accounting for 30% of our Physical IP royalty. And the team is engaged with customers and potential customers, creating processor optimization packages beyond 32 nanometers. And if you take all this together, it paints a very encouraging picture for Physical IP royalty growth in future. Meanwhile, we're continuing to work on productivity within the division and so we expect costs and headcount there to remain relatively flat.

Our Tools division. In addition to the underlying run rate business the revenues there were $15.6m in Q3. And so the underlying run rate business was boosted by three large higher-value deals being signed. Now that does happen from time to time in our Tools business; it is quite lumpy. We don't expect that to be repeated in Q4. So the Q4 revenue there is likely to be more similar to the Q2 level of just over $13m.

If I look now at the operation more generally and marketing. We've continued hiring, especially in our processor design teams, to accelerate the development of our next-generation products. The total ARM staff number is now 1,861 at the end of the quarter. So that was a big add in Q3; we added 86 people. However, that includes the majority of our graduate intake. And so having increased our headcount quite substantially in Q3, we expect the trajectory going forward to be a much more modest rate in Q4 and beyond.

Demand for places at our Annual Partner Meeting in August was very strong, so strong, in fact, that we were capacity-limited. And our partners there discussed the future processor roadmaps, new physical IP products and progress in our ecosystem, with things like Linaro. So that's a very encouraging underlying backdrop for the pipeline. Linaro itself is making excellent progress. We now have some 70 engineers assigned from the member companies and it's on track to make the first release in early November as planned.

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In a few weeks' time we're going to celebrate ARM's 20th birthday at the end of November. And after 20 years the ARM partnership has collectively shipped over 20b ARM processors. And continuing on the theme of 20s, we're thanking our partners now for their help in achieving this milestone. And with the product roadmaps we now have in place, we're challenging ourselves and those partners to achieve 100b ARM processors by 2020.

So that's about it. In summary, we're entering the final quarter in very good shape. Our order backlog's at a record level. The license opportunity pipeline is healthy. The royalty momentum is continuing. The market expectations have risen steadily throughout the year and we expect a further sequential increase in ARM revenue for the next quarter.

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

Tim Score - *ARM Holdings plc - CFO*

Thanks Warren. Morning everyone. Hopefully many of you will have had a chance to have a quick look at the Q3 earnings release for help in building your models. The quarterly slide set is available on our website as usual. You also may find it useful to review the notes at the back of the release, notes 513 to 516, where you'll find a line-by-line reconciliation of normalized numbers, which tend to be the focus of analyst consensus estimates to the IFRS numbers.

So overall Q3 dollar revenues, as Warren said, of $158.1m, 29% up both in Q3 and year to date, with robust growth in license and royalty revenues across both PD and PIPD.

The $10m or 7% beat versus consensus dollar revenues, which are just over $148m, resulted in earnings being only marginally ahead of consensus in Q3 for two reasons. Firstly given the weakening of the US dollar through Q3, the effective FX rate for ARM's revenue in Q3 was $1.5750 compared to a consensus of $1.53. And, as we know, consensus is largely compiled in the few days and couple of weeks straight after our results when, of course, the dollar was stronger.

Secondly, the net impact of our quarter-end marking to market of derivative instruments, such as forward contracts for hedging and derivatives embedded in trading contracts, was a net charge in Q3 compared to a net credit in Q2. You've heard me say many times before that the net impact of this marking to market is typically in the minus GBP1m to plus GBP1m. And this time, because there was a swing from a credit to a charge, it had a bit more of an impact in the Q3 OpEx numbers. I'll talk a little bit about OpEx outlook in a moment.

But following the strong licensing performance in the third quarter, we've also -- and the 20% uplift in the Group order backlog at the half-year, backlog is up again in excess of 10% at the end of Q3. And the opportunity pipeline for Q4 looks strong. The usual analysis of backlog maturity and composition is included in the slide set on our website. And this shows that 30% of the total backlog is expected to be recognized as revenue over the next two quarters. And approximately 35% of PD license revenue in Q3 were generated from backlog. That's a lower number than usual, and I think therefore we can take great encouragement from the fact that license revenues were well up, but not representing a big draw-down from backlog, because we're actually seeing a significant increase in backlog as well, which is encouraging.

Gross margins in Q3 were 94%, consistent with recent quarters. And normalized OpEx in Q3 was GBP56.6m compared to the guidance given in July of GBP53m to GBP55m. And, as I've said earlier, the sequential increase to a level just above the top of the guidance range is largely due to the impact of a weaker dollar on the accounting derivative instruments, resulting in the net charge versus the net credit.

Also, given the broadening growth opportunities that are available to us, we have accelerated investment in R&D in the first nine months of the year, with headcount increasing by 151 in that period, after a period of two years of really flat headcount. The uplift of 86 in Q3 includes a graduate intake of around 50. The majority of our graduate intake typically joins us in the third quarter. So whilst we expect some further improvement in Q4, we expect it to be at a lower run rate than we saw in Q3.

Normalized operating expenses in the fourth quarter, assuming exchange rates around similar levels, are expected to be in the range of GBP56m to GBP58m compared to the GBP56.6m we've just reported.

And strong revenues and a reduction in accounts receivable in Q3 have given rise to record net cash generation of GBP65m. That's a record by a considerable margin.

Now onto the outlook. As Warren said, we enter the final quarter of the year with record order backlog, a robust opportunity pipeline for licensing, both in Q4 and beyond, and strong momentum as ARM continues to increase penetration across its target markets. And we expect this momentum to drive further sequential revenue growth in the fourth quarter.

Just to be clear how this guidance compares to consensus, because we're aware that the wording is somewhat different from our typical wording that we use, where in previous quarters we've typically referred to being in line with consensus, albeit consensus that's been increasing through the year. The numbers -- coming into these results, consensus estimates for Q4 dollar revenues were $158m. Today we're reporting Q3 revenues at that level. And we're also saying that we expect Q4 revenues to be higher than Q3. So what we're saying is that the over in Q3, that does not represent in any way a bring-forward from Q4. And, indeed, we're saying that we expect Q4 revenues to be higher than the current consensus of $158m.

And looking further ahead, despite an uncertain macroeconomic environment, of which I think we're all aware, we believe that ARM remains well positioned for growth, with leading semiconductor companies increasingly adopting our technology in a broadening range of end markets.

And now we'd like to open up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from Francois Meunier from Morgan Stanley. Please ask your question.

Francois Meunier - *Morgan Stanley - Analyst*

Hello, Tim. Hello, Warren. A bit of a question on this architecture license for servers. Can you give us a bit more detail? And anything you could give us about the nature of this, maybe the timeline and where do you see the server market going forward for ARM, in 2012, 2013 or is it going to be later?

And also if you could give us a bit more details about the timeline for the chips which are being designed for laptops as well. Thank you.

Warren East - *ARM Holdings plc - CEO*

Okay. Right then. Well, I agree that the comment we made about the architecture licensee was quite vague, and it was deliberately so because the nature of that agreement is confidential at the moment with the semiconductor partner concerned. So we've said all we can say about that agreement on its own.

More generally about what the ARM partnership is doing in this space, right now we're seeing people experiment with the chips. Chips developed to date are targeted at high-end smartphones. They're not ideal for server applications. And so we're seeing semiconductor companies experimenting by building different system chips around our microprocessor cores to target that space. The one agreement announced about the architecture licensee is just one example of that.

We're not really therefore expecting any material impact as far as royalty is concerned for several years hence. I think this is a 2013 by the time we see the server chips hitting the market, and then we're going to have design-in ramps and so on. So it's going to be really something -- before there's a material movement it's going to be in the five years and beyond period.

And as for the laptops that you mentioned, I think this is about evolution of mobile computing, where this year we're seeing tablets. Tablets are like very high-end smartphones with big screens. And we're seeing an increasing number of the chips that were originally developed for smartphones and are now being developed for high-end smartphones being targeted at some of these alternative form [factors]. So I think that's about it.

Francois Meunier - *Morgan Stanley - Analyst*

Okay. Thank you.

Operator

(Inaudible), please ask your question.

Warren East - *ARM Holdings plc - CEO*

I think whoever is trying to ask the question's on mute.

Operator

The line has been opened.

Warren East - *ARM Holdings plc - CEO*

Perhaps we should move to the next question while the mute's being resolved.

Operator

Please ask your question. Gareth Jenkins?

Gareth Jenkins - *UBS - Analyst*

Yes, hi. Can you hear me?

Warren East - *ARM Holdings plc - CEO*

We can now, Gareth, yes. Hi.

Gareth Jenkins - *UBS - Analyst*

Yes, sorry. I didn't hear my name shouted out there. A couple of quick questions, if I could. Tim, on the working capital movement, you mentioned it's accounts receivable. I just wondered what work you've done there to improve receivables and whether that's replicable going forward.

And secondly, on uses of cash. Obviously the cash pile very strong indeed. I just wondered whether you can give us an update on uses of cash.

And then secondly, just one for Warren. On the Mali side of things, two new licensees. I just wondered if you could give us an update on the progress of Mali in the existing base, so particularly with the STMicro set-top box deal. Thanks.

Tim Score - *ARM Holdings plc - CFO*

Yes. Okay, Gareth. On receivables, I think that what we've seen in the third quarter is a couple of fairly significant items that were in the receivables at Q2 being paid. I think if you look at the general management of receivables and the day sales outstanding, it's fairly consistent and fairly low. Obviously on a quarterly basis you're going to get a little bit of lumpiness. And I think 65m net, and obviously if you look at the annual clean profit run rate you're not going to have an average of 65m per quarter. But certainly the elevated levels of net cash generation that we've seen in recent quarters in the 30s and 40s I think is what we should expect going forward.

So generally we end the quarter, third quarter at GBP252m. It's probably also worth saying actually that the dividend, which was actually paid on October 4, was actually out of the cash balance at the end of September and sitting in other debtors because it was on its way to the registrars but out of the bank account. So actually, on a like-for-like basis, the cash would have been 267m at the end of Q3 compared to last year. So that's worth factoring in when you're looking at what cash is going to be at the end of the year.

But generally GBP250m going north. We, as you know, have a progressive dividend policy in place. We increased the interim by 20%. That is the plan of record. We have done buybacks relatively aggressively but not recently. They still remain an option. We don't have a plan to build a cash balance war chest for acquisitions, so you will be hearing more from us on capital structure management generally. But nothing specific to report today. The plan of record is, as I say, the dividend policy. But we're obviously very encouraged by the significant acceleration in cash generation in recent quarters.

Warren East - *ARM Holdings plc - CEO*

Okay. And switching to the Mali question. There were two licenses in the quarter. Nothing strange about the application areas. One was for digital TV. One was for a mobile application. And so it's very much business as usual with those particular agreements.

Progress more generally on Mali. We're encouraged by the licensing that's going on. We're seeing initial royalties start to come through. And in things like the big set-top box activity with STMicro, specifically about that, I'd think you'd have to ask ST about that, not us. But, more generally, we're encouraged by the developing ecosystem around the Mali architecture.

Gareth Jenkins - *UBS - Analyst*

Thanks.

Operator

The next question comes from Sandeep Deshpande from JPMorgan. Please ask your question.

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Sandeep Deshpande - *JPMorgan - Analyst*

Yes. Hi. Thanks for letting me on. Just a quick question firstly on -- in terms of your design wins within the new emerging device market, Warren, can you comment on -- do you know how many new devices were tablets or any of these other new emerging devices that are using ARM? And how do you see that market developing for yourselves into the next year?

And secondly, within the existing markets, have there been any major changes in your market share? One of your old competitors who never really had any success in the handset market has talked about some wins in the handset market. Have you seen them in any of the markets that -- at any of the customers that you actually get royalties from?

Warren East - *ARM Holdings plc - CEO*

Okay. Let's start on that, Sandeep. In terms of design wins in new sorts of applications, we think, at the moment, we've seen about 40-odd tablets design-in opportunities and 40-odd others in that space. Right now it's a quiet period ahead of CES in January. And I think our visibility on which of those design wins are going to translate into products launched next year will really have to wait until CES, because people are guarding quite carefully their detailed product plans.

Could you just repeat the second part of your question?

Sandeep Deshpande - *JPMorgan - Analyst*

Have there been any changes in market shares within existing products, such as hard disk drives or any other products that you have, as well as the third part of the question was regarding one of your old competitors has said that they're taking some wins within the handset space. Are you seeing that at all?

Warren East - *ARM Holdings plc - CEO*

So on the market share, we'll update the numbers on the slides that we have in our pack only once a year, but just for the quarter just gone, basically in each one of the sectors we're reporting out-performance of the wider market. So microcontrollers up 65% versus 50% overall, TVs up 40% versus 20% overall, hard disk drives a similar number but I haven't quite got it in front of me at the moment. So I think -- sorry, hard disk drives, we're up about 50% versus an industry up about 20% overall. So, if you take those numbers, you can see we are gaining in market share in those more established spaces.

And as for competitors in the cell phone space, then yes, we've seen one or two headlines about design wins. But frankly we continue as we look forward to see our position very strong in the traditional areas, and getting stronger all the time in the apps processor space as the ecosystem develops around it, and continuing to be strong in the baseband modem space and in evolving baseband modem standards.

Sandeep Deshpande - *JPMorgan - Analyst*

If I ask a quick question for Tim on hedging policies. Given that the sterling has strengthened against the dollar, is the [whole] policy going to remain that essentially, as sterling strengthens, that will impact your earnings? So you do not intend to hedge long term or anything like that which will change the earnings profile?

Tim Score - *ARM Holdings plc - CFO*

We don't have any current plans, Sandeep, to change our hedging policy which, as you know, is hedging surplus dollars a quarter or two ahead. We don't plan to be taking any long bets on currency. I think it is understood generally the impact of the dollar/pound relationship on ARM profitability. But I don't think we've managed to identify any magic bullet or golden solution that means we can become immune from that.

Sandeep Deshpande - *JPMorgan - Analyst*

Thank you.

Operator

The next question comes from Simon Schafer from Goldman Sachs. Please ask your question.

Simon Schafer - *Goldman Sachs - Analyst*

Yes. Thanks very much. I actually wanted to ask a question about PIPD. Year to date you've shown, I guess, almost 20% revenue growth on a year-over-year basis. And I realize that under the way you think about profitability, the way that you report under IFRS may not be representative of the genuine profitability of that business. But under IFRS obviously it's still loss-making. I wonder as to how close you think you are in terms of delivering or getting closer to profitability on an IFRS-reported basis, just in light of the deal that you've struck recently in PIPD.

Tim Score - *ARM Holdings plc - CFO*

Yes. The context of this, Simon, is, as I think you've heard us say before, we've been very clear that we think PIPD is a gradually improving business across multiple dimensions in terms of technology portfolio, zone operations and everything else. And what we've been saying is that we expect revenue growth from here at a faster rate than cost growth. We see most of the investment you've seen in headcount this year in ARM is in the Processor division and, to a lesser extent, in the Media Processing division, but PIPD staying fairly flat.

So what we actually expect is a pretty long-term trajectory of increasing contribution from that division and therefore being additive to Group profitability rather than the reverse. I think on a fully allocated segmental reporting basis under IFRS, you need to be thinking around PIPD as somewhere around $100m per annum to be breakeven on that basis. But, as I say, incremental revenue growth in PIPD right now is additive to Group profitability.

Simon Schafer - *Goldman Sachs - Analyst*

Got it. Very clear. Thank you. And my second question would be just on the core licensing side, you're back to low to mid 40s in quarterly revenue now in dollar terms for the core licensing, which is relatively similar to the type of peaks that we were seeing in 2007. Obviously there's much more non-mobile skew. But I wondered, going forward, do you think, just by virtue of how quickly the backlog's building, that's still growing in line with longer-term industry growth of the semiconductor industry or are we getting closer to run-rate levels than in the mid 40s on a quarterly basis? Thanks.

Tim Score - *ARM Holdings plc - CFO*

Well I think what you've obviously got here Simon is a larger installed licensing base. We've got a very broad range of products for licensing. And an ARM is being designed into a much broader range of markets, so -- and a very high backlog historically. So we would expect, as we go into 2011, to have a higher backlog coverage of target revenue than we typically see. So, whilst it's very difficult for us to talk about specific quarterly license revenue, I think it is realistic to expect it running at a higher level than we've seen in recent quarters.

Simon Schafer - *Goldman Sachs - Analyst*

Got it. Thanks very much, Tim.

Operator

The next question comes from Johannes Schaller from Deutsche Bank. Please ask your question.

Johannes Schaller - *Deutsche Bank - Analyst*

Yes. Hello. Thank you for taking my question. The first one is on royalty ASPs. You saw a slight up-tick in ASPs this quarter after a decline for maybe the last one-and-a-half years. I just was wondering, with the mix shift into more MCUs, do you think the current level is sustainable for the next two or three quarters or maybe even longer?

And then the second question is really hiring and OpEx. You said your trajectory for hiring going forward will be more modest. So do we also have to think of basically a more modest OpEx trajectory?

And maybe a follow-on here. Do you -- can you maybe quantify this FX impact you had on derivatives? Is that like minus GBP1m to plus GBP1m roughly? But can you give a more precise number here? Thank you.

Warren East - *ARM Holdings plc - CEO*

Okay. Let me start talking about ASPs. And, as you rightly point out, this is essentially a product mix issue. And as microcontrollers grows as a proportion of the total, that exerts downward pressure. And as application processors in more expensive smartphones grows, it exerts upward pressure.

We have seen over recent years, in Q1 '08 and in Q1 '09, we've seen increases in the average royalty per chip. And so this isn't a totally unheard of phenomenon. And, in fact, I think those two rises are rather more about seasonality and the fact that things like microcontrollers are a more even growth in penetration, because they tend to go into industrial applications which are not seasonal. Applications processors in things like smartphones and mobile computers tend to be a little bit more of a seasonal activity. And so we should expect to see more upward pressure at those times of the year.

So what we've seen now is not unheard of. It's encouraging to see that. It basically means in spite of a 65% increase in microcontrollers, the effects of the high-end app processors has outweighed that downward pressure. As we model it going forward, we see both of those sectors continuing to grow strongly. So it's -- really we would expect stability, but you're going to see quarterly fluctuations, some of them seasonal.

Tim Score - *ARM Holdings plc - CFO*

On the OpEx question and the headcount growth that we've seen year to date, I don't think this in any way changes our medium- to longer-term guidance that we give that says that we think we can broadly grow revenues at double the rate of cost in this business. We've kept a very flat headcount now over the last -- back over the last three years, including the activity in Q3, our headcount has grown something just under 7%. And looking at consensus revenue estimates for this year, revenues over that period are probably, notwithstanding the downturn, going to be in the 15% to 20% growth range.

I think looking forward, so we've done a little bit of catch-up with people, having kept it very flat. We've also been doing some accelerated development at various critical parts of our roadmap, to seize the opportunities that we have. But, as I've said, I think you can expect the rate of hiring to be much flatter going forward than we've seen in the period so far this year. And, as

I say, consistent with our longer-term guidance, which means that we expect the same operating leverage out of this business going forward as we've talked about in recent quarters and years.

On the FX front, there's always -- the difference there is in the GBP2m to GBP3m range.

Johannes Schaller - *Deutsche Bank - Analyst*

Okay. Perfect. Thank you very much.

Operator

The next question comes from Paul Morland from Peel Hunt. Please ask your question.

Paul Morland - *KBC Peel Hunt - Analyst*

Good morning, guys. Just a follow-up really to Gareth's question on the Mali, the answer being that two licensees were in digital TV and mobile phones. Can we deduce from that that Mali's not being designed into tablets just yet?

Warren East - *ARM Holdings plc - CEO*

I think it's a bit -- that's -- I said mobile. As far as we're concerned, tablets are a special case of mobile, so you certainly shouldn't deduce that from what I said.

Paul Morland - *KBC Peel Hunt - Analyst*

Okay. Thanks. And the other question's more a sort of general one around consensus. If the embedded derivatives hit was around about GBP3m and the quarter and your royalty outlook is unchanged, confirm if it is, and I think that's back to a more normal level of 10% to 15% growth next year, would you expect consensus for 2011 to move up to around about 10.4? I think it's 10.2 ahead of these numbers? Does that logic make sense?

Tim Score - *ARM Holdings plc - CFO*

Yes. I think, obviously to be dealing with the bottom line, Paul, at this stage, you're making some bets on FX and what rates, etc., etc. I think what we would say is the outlook for dollar revenues for this business going into 2011, for the reasons that I've said, looks positive. And what we've also said is that the rate of hiring, etc., will be at a much flatter trajectory. So I think normal operating leverage metrics for ARM apply, but whether you, depending on precisely what FX rate you use, etc., on the translation line, may -- would have an impact, clearly, on earnings.

Paul Morland - *KBC Peel Hunt - Analyst*

Thanks very much.

Operator

The next question is from Jerome Ramel from Exane BNP Paribas. Please ask your question.

Jerome Ramel - *Exane BNP Paribas - Analyst*

Yes. Good morning. Just concerning the royalties coming from the Enterprise, it seems that on a quarterly basis it was down sequentially. So that's my first question, if you could explain what's happening there.

And second question, if I look at the backlog maturity, you've got 54% during -- within one year, which is the lowest level since, from looking at the data, since 2004. Any specific reason why we are seeing such a strengthening of the maturity of the backlog? Thank you.

Tim Score - *ARM Holdings plc - CFO*

I'll deal with the second one. The good news is it's 54% of a much higher number than you've seen in your -- looking back in history. So, in absolute dollar terms, it's very good news. Why is that percentage lower? It's because, in recent quarters and years, we've been doing more strategic long-term deals that actually get recognized in revenue over longer periods. And therefore the sort of future license revenue underpin from backlog goes over a longer period than it did when you were looking at 2004 and 2005. So 54% of where backlog currently is is a good number historically in terms of target revenue coverage.

Warren East - *ARM Holdings plc - CEO*

Okay. And the other question was about the Enterprise segment and royalty from the Enterprise segment. Enterprise segment for us is networking applications, hard disk drive controllers and printers primarily. And what we're actually seeing there is fairly flat in absolute terms. And I think we might be running into, when it's fairly flat in absolute terms, the law of small of numbers and rounding errors.

What we can say is that if we look year on year then we are seeing ARM growth outweighing industry growth. And that's consistent with gains in market shares. Whether there's a 10m-unit difference from one quarter to the next in a number of 1.5b units in total, I think, I'm sorry, but that's the sort of limit of our accuracy and rounding. So we are not at all concerned by that. And we are encouraged by the year-on-year out-performance of the market in that sector.

Jerome Ramel - *Exane BNP Paribas - Analyst*

Okay. Thank you. Very clear. Maybe just a follow-up. Concerning the automotive market, you are gaining share there. But I'd just like to understand your strategy in this specific market. Are you intending to eventually replace the [PowerPC] or the Tri-Core or any [of that] in the [power chassis]? Or do you just want to focus on the dashboard basically?

Warren East - *ARM Holdings plc - CEO*

Well, we don't want to just focus on the dashboard, but design-in cycles for dashboard are a lot shorter than cycles for power-train. And other parts of the car are somewhere in between. We have seen us growing in automotive, and that's increased use of ARM technology in things like the dashboard. As more dashboards become more sophisticated, it's increased use of ARM in sensor applications. We think automotive is a good market to be in because it's long-term growth for electronics in automotive.

But power-train in particular is a very difficult one to crack. The architectures are very established. And each car tends to only have one power-train controller. And therefore the volumes are not so exciting for us. So we're going to let that one happen at its natural speed. And, as we gain share in microcontrollers generally, then we can see a lot of opportunity in automotive. And as cars become more sophisticated at the dashboard end, we see a lot of what we're doing in consumer and entertainment spilling over into automotive as well.

Jerome Ramel - *Exane BNP Paribas - Analyst*

Okay. Thank you very much.

Operator

The next question comes from Gunnar Plagge from Nomura. Please ask your question.

Gunnar Plagge - *Nomura - Analyst*

Yes. Hello. Thanks for taking my question. I wanted to come back to the PIPD division. You reported quite a jump in the royalties from advanced nodes to about 30%. Maybe you can speak about this.

And then could you maybe also talk a little bit what you hear from your sales force when you talk about the, let's say, what you call the big [shippers] within the foundries, so the fabless companies. What is the main reason at the moment that they are still using in-house PIPD's? So is there interdependencies with other areas, elements that need to be added? Are these more internal politic issues? And clearly you also commented on the optimization packages. Thank you.

Warren East - *ARM Holdings plc - CEO*

Right. Well, if you look at the history of what we've down with your Physical IP business, we were very clear up to 2007 that we needed to concentrate on developing products at the advanced technologies end to intercept the market. And the growth that we're now seeing in advanced technologies is, I think, a consequence of that focus. And it's very encouraging for us to see the products that we developed, which we have seen adopted over the last few years, now coming through in royalties. And we would expect that trend to absolutely continue.

As far as the larger fabless companies are concerned, in-house Physical IP is very much the order of the day. And I think the pressure to move outside becomes increasingly visible as we go to technologies of 32 nanometers and beyond. Our product portfolio, we understand from engaging with these customers, is much more in the ballpark of what they're looking for than it was several years ago. And we've got a lot of discussions ongoing that are very encouraging.

However, internal designs are very sticky. There's no reason to actually change when you have products already developed. And therefore it's going to be, initially, in areas like the processor optimization packages where we can do something that the in-house teams can't do. And that's where we're going to, I think, make an initial penetration with those customers. So we're pretty encouraged by the interest that we're seeing from the processor optimization packages.

Gunnar Plagge - *Nomura - Analyst*

Okay. Thanks.

Operator

The next question comes from [Vishal Gupta] from Execution Noble. Please ask your question.

Warren East - *ARM Holdings plc - CEO*

Another mute problem? We can't hear anything at the moment, sorry.

Operator

The line's open. I don't think he's there, responding. So your next question comes from Brett Simpson from Arete Research. Please ask your question.

Brett Simpson - *Arete Research - Analyst*

Yes. Hi. Good morning. Can you hear me, guys?

Warren East - *ARM Holdings plc - CEO*

Yes.

Brett Simpson - *Arete Research - Analyst*

Okay. Hi. So a quick question for Warren. I guess we've seen a lot of acquisitions in the design chain and I wanted to get your perspective on them. EDA players have been quite active and moving into chip IP and physical IP. And it seems like when you add on the Intel M&A as well, there's a lot of change in the landscape. And when you look at some of these changes we're seeing coming through, are there areas that you feel it makes sense for ARM to strengthen here?

Warren East - *ARM Holdings plc - CEO*

Well of course we look at those all the time. And we do, from time to time, do something to grow in IP. It just so happens that we haven't this year so far. We may well do so next year if the right technology is available to flesh out our portfolio.

The sorts of moves that we've seen in the acquisition of Virage and so on are not altogether surprising. The EDA space is notorious for flat revenue in the core business. And if you want to grow your revenue, then that's one way of doing it. Our approach, however, is it be agnostic and independent. And, with the acquisition of Virage, our physical IP is now the only significant truly independent physical IP that's there on the market. And so we actually see that as a serious benefit for our physical IP.

Brett Simpson - *Arete Research - Analyst*

And maybe just a follow-up. I wanted to get a bit of clarity on the mobile royalties side of the business. I think you said in your remarks 1.5b cores overall and about 61% was mobile. And you said that the cores performing ticked up to 2.7. And if I just back that out, I get a handset number that's broadly flat in the June quarter versus the March quarter, around about [230m] handsets. Is that the scenario you're suggesting, because it seems there's a bit more growth in the quarter for the industry overall?

And maybe just to add to that, on the mobile phone -- regarding your mobile phone royalty ASPs, directionally, can you talk a bit more specifically about what you're seeing, particularly in light of some price cuts in the low end from guys like MediaTek?

Warren East - *ARM Holdings plc - CEO*

Yes. Okay. First of all a little bit of clarification on mobile. The mobile up 61%, that is including things like tablets; it's including MP3 players. Bluetooth headsets are also included in that. So we need to be carefully about what we're actually counting as mobile. If you look on our slides, then where we have mobile as a category it's covering several application spaces.

As for ASPs in the mobile space, then it's a mix. And some companies will use pricing to penetrate markets, and we have seen explosive growth from companies like MediaTek over the last several years. We're now seeing a bit of competition for MediaTek as well. I think these lower-priced application processors are -- they're good for driving growth in smartphones overall. A smartphone, even at low-priced applications processors, is still generating vastly more royalty for us than an alternative, which would be, if you take that consumer who's bought a cheap smartphone, the alternative is probably that they buy a basic phone where we'd earn even less royalty. And once they've got on to a cheap smartphone, the next phone they purchase is likely to be a more sophisticated smartphone. So actually, we think that's part of the landscape and it's well baked in to our expectations.

Brett Simpson - *Arete Research - Analyst*

And Warren, if I can just maybe ask a follow-on here. In terms of your mobile phone royalties per phone, absolute mobile phone royalties per phone, directionally do you think that should sustainably rise over the next couple of years? Or, as we see more and more lower-priced smartphones, we see a little bit more ASP pressure from the chipmakers, should we see that flatten out? What's your perspective there?

Warren East - *ARM Holdings plc - CEO*

Well actually I think we can continue to see it rising. What you've seen over the last few years is an inexorable rise in the number of ARM processors per phone. And we produce that as a metric because it's much easier to track than trying to analyze in detail the royalty that we are earning per phone. But all the time these phones are starting to use more and more ARM processors. And so individual chip prices we can see declining, yes; but we can see a big offset there in the number of ARM processors per phone.

Brett Simpson - *Arete Research - Analyst*

Thanks very much.

Warren East - *ARM Holdings plc - CEO*

Thanks.

Operator

The next question comes from Janardan Menon from Liberum Capital. Please ask your question.

Janardan Menon - *Liberum Capital - Analyst*

Yes. Hi. Thanks for the question. Just, actually it's touching on the previous questions as well, which is when I calculate your unit shipments quarter on quarter from Q2 to Q3, the biggest growth seems to have been from the embedded area. So I'm just confused as to why your ASP went up and what were the factors there. I know you said that rate of royalty is going up. Was that a significant driver just from Q2 to Q3 or is that a general ongoing phenomenon which will affect it in the longer term? And so can you just clarify what exactly was it that drove it out from Q2 to Q3, despite the stronger growth in microcontrollers?

The second question I have is, if you look at the consumer electronics market, it seems to be quite a crowded market where you obviously have a lot of design win activity going on there. And your competitor, MIPS, claim that they are the leaders in that area, presumably on the back of Broadcom set-top boxes and some of the TVs in the Far East. And Intel is coming through with the Google TVs as well. So I was just wondering how you see that market evolving. Could that be a market which is going to have multiple players and not really a uniform sort of architecture like we've seen in PCs or in mobile phones? Or will it -- do you expect it to finally conform to a single architecture in the longer term?

Warren East - *ARM Holdings plc - CEO*

Okay. There's a huge number of questions there, but let's start with the first one which was about the average chip royalty. And yes, there's no surprises here. What's driven it up is the upward pressure from the Cortex-A based application processors, which are more expensive chips and are going into the more sophisticated phones. We've seen Cortex overall go to 9% of our total volume. And some of that's microcontrollers, but some of it is Cortex-A processors in smartphones. And it just so happens, when you do the arithmetic, that this is one of those quarters where those A-based chips started to exert some upward pressure. We don't make a big noise about it, but some of those higher-value microprocessor cores do command a higher royalty rate as well because our customers see greater value in those microprocessor cores.

Now the question about the TVs and the consumer market generally, yes, MIPS does have a very strong position with companies like Broadcom. But design wins, like the ST design win from -- that was public 12 months ago, do mean that ARM is on a trajectory to grow market share. We've had other digital TV design wins even this quarter. There's some others. I don't know if Trident is now public with their use of ARM technology as well. And so we're expecting DTVs to be up about 50% in 2011, and we expect to take a greater share. MIPS will continue to present in the designs from companies like Broadcom; it's a competitive market.

New emerging things, like the Google TV, based around the Intel architecture, that has some benefits. But actually that's a hugely energy-consumptive design. And I think, in the long run, people will want to not pay for expensive heat sinks and those sorts of things in those sorts of designs. And so we do see digital TVs going the same sort of way as mobile phones, with eventually a standardization. And a lot of the ecosystem which works in the smartphone space is equally applicable to digital TVs. That ecosystem is developing around the ARM architecture. And so we think we're very competitively positioned in the digital TV space.

Janardan Menon - *Liberum Capital - Analyst*

Just going back to the first question, given that Cortex-A shipments will only keep increasing in coming quarters, the smartphone market is very strong, does that mean that even if microcontroller shipments stay strong, as they were in Q2, your ASP should keep trending up for a couple of quarters at least?

Warren East - *ARM Holdings plc - CEO*

It could be, and we would be delighted to see the application processors have that effect. But if they don't have that effect, then all it means that the volume of ARM-based microcontrollers has risen even more steeply. And that's generated incremental royalty for us and more land grab in terms of designers using ARM technology. So actually, if that was the outcome, we'd be pretty pleased with that as well.

Janardan Menon - *Liberum Capital - Analyst*

Okay. Thank you.

Operator

The next question comes from Jonathan Crossfield from Bank of America. Please ask your question.

Jonathan Crossfield - *Bank of America-Merrill Lynch - Analyst*

Hi. Good morning. Just a couple of quick ones. Tim, I think you mentioned that the Q4 licensing pipeline looked reasonably strong. Do you think we could see the backlog up again sequentially off these record levels?

And then sort of linked in with that, we had another architecture license in this quarter. Are you seeing -- do you think there will be more architecture licenses going forward than there have been in the past as companies focus on application-specific developments?

Tim Score - *ARM Holdings plc - CFO*

Yes. Hi, Jonathan. Yes, the Q4 licensing pipeline is actually very strong. And exactly what happens to backlog at the end of the year will depend on which deals sign which side of the year end. But I think what we say in the release that the prospects for the backlog remain promising. And I think you've been covering ARM long enough to know what that probably means.

In terms of architecture licenses, I don't necessarily think you should assume that architecture license is going to become a higher proportion of the total license model mix. It is a model that we use a handful of times in a year but no more. So I wouldn't expect particularly an increasing trend in that.

Jonathan Crossfield - *Bank of America-Merrill Lynch - Analyst*

Okay. And then just a very quick follow-up, which is just on the share-based comp. I guess it's largely a function of the share price, but should we anticipate that staying around the Q3 level going forward, having stepped up from 9m, 10m to 13m or so?

Tim Score - *ARM Holdings plc - CFO*

I think we expect that to reduce, Jonathan. There's an element of having to -- well, accounting for likely outcomes on things like rolling LTIP plans, given the relative total shareholder return that ARM is running relative to the peer groups. So there's a been a little bit of catch-up with that. But I would expect it to revert to more normal levels.

And also, in terms of absolute numbers of shares issued and therefore potential dilution, as I think we've said a number of times before, the share-based remuneration at ARM is based more on a percentage of salary not on a number of shares. And therefore, with a higher share price, the number of shares reduces. And therefore, in a sense, there's a self-correcting mechanism, so the number should stay quite consistent on an IFRS 2 basis, but reduced from this current quarter level, which I think will be unusual.

Jonathan Crossfield - *Bank of America-Merrill Lynch - Analyst*

Okay. Great. Thanks very much.

Tim Score - *ARM Holdings plc - CFO*

Thanks.

Operator

The next question comes from Nick Hyslop from RBC Capital Markets. Please ask your question.

Nick Hyslop - *RBC Capital Markets - Analyst*

Good morning, Tim and Warren.

Warren East - *ARM Holdings plc - CEO*

Good morning.

Nick Hyslop - *RBC Capital Markets - Analyst*

I wonder if we could just come back to tablets. And I hoped that you can talk a little bit, excluding where we are with Apple, just outside of Apple, whether you could talk about which operating systems you see as likely to be emerging as the most dominate in these sort of 40-plus designs that you've been talking about, and whether that interest in ARM-based tablets is having a bearing on Microsoft's ultimate decision on what they do or do not do with their own operating system in this space.

Warren East - *ARM Holdings plc - CEO*

Yes. Well obviously, at the moment, the dominant operating system is Linux-based stacks. People are stretching Android into bigger screens; there's a lot of that going on. As I said at the beginning of the call, exactly which of these designs make it into the market, I think we'll get the next decent read on that at Consumer Electronics Show in January. What we have seen is people, the members of The Linaro Consortium, being very enthusiastic about taking that forward; the first Linaro release will be out in a few weeks' time. And we've seen positive reception to that from the people who are building products, because it does make life a lot easier for the Linux world.

Microsoft, there's a very quick way of producing a tablet at the moment with an ordinary desktop Microsoft operating system and making some minor changes there. Microsoft themselves introduced Windows Mobile 7 a little while ago, as you know. That's all ARM-based, and potentially, I'm sure, you will see people trying to stretch that to larger screens and bolt on the sort of interfaces that are appropriate for tablets. And I think that can only exert pressure on Microsoft. But, as I've said many times before, this market is going to happen with or without Microsoft. And it's very much up to them what they do with their operating system and the ARM architecture.

Nick Hyslop - *RBC Capital Markets - Analyst*

Okay. And when you look at the forecast for tablets next year, do you -- is there any particular forecast you think is more credible than others? Do you think around 30m units is a reasonable guess or --?

Warren East - *ARM Holdings plc - CEO*

I think it could be more than that actually as we look into next year. But, in a way, for us it all -- it matters a lot, but the actual number is less important than the number of active designs, because it's people innovating around the ARM architecture. It's things like the Apple iPad having the same sort of impact on these types of products as the iPhone had on smartphones a very years ago, so stimulating lots of competition.

For us, from a royalty point of view, a tablet is essentially a very high-end smartphone. And so compared with the hundreds of millions of smartphones shipped, whether there's 30m tablets or 40m tablets next year is less important than the mix of smartphones.

Nick Hyslop - *RBC Capital Markets - Analyst*

Okay. Thank you very much.

Ian Thornton - *ARM Holdings plc - VP IR*

I think we've got time for one more question.

Operator

There are no further questions at this time.

Warren East - *ARM Holdings plc - CEO*

Excellent. Well, thank you very much, everybody, for your participation. And we'll be back with our annual results at the beginning of February, and look forward to talking to you then.

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.