

FINAL TRANSCRIPT

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ARM.L - Q3 2008 ARM Holdings plc Earnings Conference Call

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PRESENTATION

Operator

Thank you for standing by and welcome to the ARM Q3 results analyst and investor call. At this time all participants are in a listen-only mode. There will be a presentation followed by question and answer session. (Operator Instructions). I must advise you all that this conference is being recorded today, Tuesday October 28, year 2008.

I would now like to hand the conference over to your speaker today, Mr. Ian Thornton. Please go ahead sir.

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Ian Thornton - ARM Holdings plc - Director IR

Thank you. Good morning, this is Ian Thornton, Director of Investor Relations at ARM. On today's Q3 and nine months' 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 up the call to a Q&A session.

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

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

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

The following conference call will contain forward-looking statements which are other and 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

Thank you Ian. Good morning everyone, thank you for joining our Q3 '08 results call. I'll run through some of the highlights and then hand over to Tim.

So for Q3, we're pleased to report that we exceeded the previous high set in the first quarter of this year, to achieve another record quarter for revenues, dollar revenues of \$134.4 million, which was ahead of consensus expectations.

The quarter also saw a good sequential increase in our Processor Division license revenues, record volume shipments of 1 billion units in a quarter for the first time, further progress with Tier 1 semiconductor companies for our Physical IP Division, and the initial benefits from the stronger dollar contributing to higher margins and an increase in earnings of over 20% year-on-year.

So now I'll go into a little bit of detail around the business. As you know, Q3 can be challenging at the best of times in the ARM world, and the business environment this year has prompted many questions. However to date, our Processor licensing has proceeded as we would normally expect, with revenue up 18% sequentially to more normal levels, and the number of licenses sold to generate future royalties growing our base out there from over 550 to 566 licenses, that's 13 licenses in the quarter.

And those licenses came from all processor families during the quarter, including two licenses for our Mali graphics processors. ARM7s and ARM9s continue to license, further demonstrating the longevity of these products.

If you look at what semiconductor partners are intending to do with those licenses, then the applications targeted remain very broad. Once again, 75% of licenses were targeting initial use outside of mobile applications.

The quarter started with an agreement with STMicro to become the lead partner for our next generation Mali graphics processor, which includes multi-process technology that we first developed with the ARM11 MPCore and later used with the Cortex-A9.

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We added two new semiconductor partners in the quarter and over the last year, where there's been increased consolidation in the semiconductor industry, the number of new partners has offset the consolidation effect. And the total number of licensees remains in excess of 200.

Looking at what our partners are doing by way of shipments; partner shipments continued to grow in the second quarter, which we are now reporting as Q3 royalty for ARM. Year-on-year volumes grew 45% overall. A strong performance in Home, Embedded and Microcontrollers approximately 50% and an even stronger year-on-year performance in Enterprise, driven by WiFi, fixed net working and hard disc drive products.

We had a continuation of growth in smart phones, which helped push the overall mobile shipments up by 40% and sat behind that, we can see ARM11 shipments now representing 3% of total volume shipment. That's about three times the volumes we were seeing 12 months ago on ARM11. And collectively, that left us with record volumes of 1 billion units overall.

If I look so far in 2008 for the first nine months, our reported partner volumes are over 96% of the total volume achieved in the whole of 2007.

Switching now from the Processor Division, looking at some other parts of the business. After the restructuring which we initiated earlier this year in our Systems Design Division, that's our Development Systems, the Development Systems revenue was up 18% year-on-year. And at the end of the quarter in that division, we released the latest version of our mainstream software development toolkit, that's our BBS 4.0, provides an approximately 10% improvement in performance, 40% improvement in memory usage compared with the previous versions of those tools, and that enables our customers to build even more cost effective, competitive products with ARM processors. So that division's going pretty well.

Now switching over to our Physical IP Division, overall revenue was ahead of 2007, with royalties significantly ahead and license revenue lower year-on-year. During the quarter, we sold 14 physical IP licenses.

License booking with Tier 1 semiconductor companies however tells a slightly different story and here we've been reaping the benefits of our focus on leading edge technology development over the recent quarters. The quarter began with the already announced 45 nanometer agreement with STMicro -- actually it's 40 nanometers agreement with STMicro, and closed on September 30 with the announcement of a multi-way agreement with IBM's common platform partners for development of 32 and 28 nanometer physical IP, which opens the way for additional licensing opportunities in 2009.

And in between those two events, we signed further agreements with two Tier 1 semiconductor companies, one buying from us for the fourth time in successive quarters, and the other buying physical IP from us for the first time.

We've also had more companies licensing physical IP optimized for use with ARM processors, creating higher performance mobile computers or smaller, cheaper microcontrollers. So the momentum for our leading edge physical IP is really building.

From a technology point of view, the technology development continues. During Q3, a year on from when we first began our work on 32 nanometer products, we taped out our first ARM microprocessor using our 32 nanometer physical IP.

Switching to royalty, Physical IP royalty was strongly up year-on-year, including some catch-up. Physical IP royalties grew faster than the overall foundry utilization in the relevant period, which shows the benefits of market share gains based on the 1,500 or so new designs taped out every year using our physical IP.

So that's a brief summary of what's going on around the different parts of the business.

Now as we enter Q4 and the Christmas season this year, of course it feels a little different from normal. We have a very well publicized and discussed backdrop of shrinking consumer spending, careful inventory management by semiconductor companies and their customers.

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However, ARM remains very strongly positioned and differentiated. Though our backlog was slightly lower at the end of September, compared with the mid-point of the year, as of now we've had a good start to Q4 and the backlog has been restored to the mid-year levels and remains about 30% ahead of where it was a year ago.

Processor licensing is supported by a robust opportunity pipeline. There's momentum in our physical IP booking, based on all the recent investments we've made in the advanced technology in that division. ARM products are continuing to be designed into a growing range of applications, driving market share gains outside of mobile, which is fuelling year-on-year growth of over 40% in all our application segments. And in mobile, we expect the mixed shift to smart phones to continue through 2009, a trend to which many of you know, ARM is highly and positively geared.

The strengthening of the US dollar has already benefited our earnings. The effective rate in the quarter was \$1.88 and since the beginning of this quarter, we've seen a continuation of that trend, as the dollar's continued to strengthen. And so far that's happened in Q4 and that will clearly accelerate any structural improvement that already exists in our margins going forward.

So right now, we're confident of achieving a good Q4, at least in line with expectations. And at that point, I'll hand over to Tim.

Tim Score - ARM Holdings plc - CFO

Thanks Warren. Morning everyone. Hopefully most of you have had a chance to look at the Q3 earnings release and just a reminder that the normal quarterly slide set is available on our website as usual. And don't forget, it's probably worth noting that at the back of our release in notes 6.24 to 6.27, you'll find the columnar reconciliation of normalized numbers, which tend to be the focus of analyst consensus estimates to the US GAAP numbers. So that's set out in notes 6.24 to 6.27.

Briefly on the headlines, as Warren said, dollar revenues \$134.4 million, 7% ahead of last year and the sterling revenues at GBP71.7 million, 14% ahead, reflecting the initial benefits from the recent, but significant, strengthening of the dollar against sterling.

Royalty revenues continue to be a key growth driver in 2008, and Q3 royalties were more than 30% up on last year in both Processor and Physical IP Divisions. So there's the increase in revenues.

Ongoing careful cost control and the strengthening in the dollar have all contributed to year-on-year increases in profits and earnings of 17% and 23% respectively, and operating margins in Q3 increased to 33%.

The Group continues to be strongly cash generative. Free cash flow in Q3 was GBP22.5 million. The share buyback program continued with a further GBP9 million being spent on the Company's ongoing share buyback program. But the Group retains its strong balance sheet, net cash at the end of the quarter GBP66 million, up from GBP51 million at the beginning of the year.

Now a little more detail on the numbers. So following slightly disappointing PD licensing revenue number of \$30 million in Q2, as we indicated in July, Q3 revenues have returned to the more normal range of \$35 million plus with, as Warren said, all ARM product families being licensed in the quarter.

Royalty revenues once again exceeded expectations, with very strong year-on-year volume growth of 44% hitting \$1 billion in the quarter for the first time, and the increase being very broadly spread across our target end markets.

PIPD revenues 3% ahead of last year but down on Q2 as very strong royalties did not completely compensate for a lower quarter for PIPD license revenue, where much of the sales activity in Q3 was focused on closing leading edge technology deals, which give rise to revenues in future quarters.

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PIPD royalties at \$11 million included \$1.7 million of catch-up royalty, with underlying royalties of \$9.3 million being 21% up year-on-year. And when considering short-term prospects for PIPD royalties, recently reported declines in foundry utilization will need to be taken into account.

Warren mentioned the latest position on the order backlog; approximately 30% up on a year ago, and still pretty close to historically high levels. In Q3, just over 14% of PD license revenues came from backlog. And the usual analysis of backlog that we provide in the slides is there on backlog maturity and composition. And you'll see when you get there that the slide shows that 37% of total backlog is expected to be recognizable as revenue over the next two quarters.

So before just closing on the guidance, a few comments on margins and costs. Gross margins in Q3 were 89.9%, a little higher than in recent quarters, reflecting, primarily, the higher proportion of total revenues made up by royalties. And at GBP40.8 million, normalized OpEx in Q3 is GBP3.3 million higher than last quarter, and a couple of million pounds higher than consensus.

This sequential increase is due, primarily, to the strengthening of the dollar against sterling, which has had two effects. Firstly, an increase in the sterling value of the Group's US dollar denominated costs, which account for, I think, as most of you know, approximately half of our total costs. And secondly, the impact of accounting for our hedging instruments has given rise to a net charge in Q3 compared to a net credit in the second quarter and, therefore, the sequential impact is negative. That's a net number that moves around each quarter and is quite hard to call. It really depends on the exchange rate at the end of each quarter.

The costs, overall, continue to be carefully managed, with Group headcount at the end of Q3 marginally lower; about four lower than it was at the start of the year.

So looking into Q4, although the underlying costs remain broadly flat, if the pound/dollar rate stays at current levels of mid-\$1.50s, we would expect OpEx in Q4 to be higher than Q3 given the translation effect on the Group's US dollar costs. More than outweighed, of course, by the benefit on revenue, which drops through to profitability and earnings.

Just in terms of your models for Q4 and going forward, a quick comment on interest received in Q3. The total interest of GBP1.2 million included approximately GBP500,000 of interest relating to a repayment of tax in respect of prior years. And, therefore, going forward, we would expect interest received to be more in line with the amounts reported in Q1 and Q2, round about somewhere between GBP600,000 and GBP800,000 per quarter.

So confirming the outlook comments, although the global macroeconomic backdrop makes a near-term trading environment uncertain, based on the order backlog we have, and the part of it that is expected to be recognized in the short-term, the robust licensing pipeline, and the underlying momentum in royalties across the Group, we expect that Group dollar revenues in the fourth quarter will be at least in line with expectations. In addition, we anticipate that profits and earnings will benefit further from the strengthening of the dollar against sterling.

And now, over to Q&A.

QUESTIONS AND ANSWERS

Operator

We will now begin the question and answer session. (Operator Instructions). Your first question comes from Sandeep Deshpande from JP Morgan. Please ask your question.

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Sandeep Deshpande - JP Morgan - Analyst

Yes, hi. Thanks for taking the call. Tim, in what you just said, I didn't understand that properly. In terms of your dollar costs or your sterling costs, did you say that in the fourth quarter your cost base will rise but that your revenue will not rise in the same line as the cost?

Tim Score - ARM Holdings plc - CFO

No. What I said was that the impact of the strengthening dollar, which would obviously include our sterling costs, as reported, because of the US dollar costs, is more than outweighed by the benefit that we will get to revenue. And, therefore, the impact on margins, profits and earnings is all very positive, notwithstanding the fact that the cost themselves, the US dollar element of those, will translate into a higher sterling value.

Sandeep Deshpande - JP Morgan - Analyst

Thanks. Secondly, regarding what you see in terms of the economic environment, you said that your backlog is now flat with what it was, 30% up over last year. If you look at your licensing profile, now you've licensed almost 49 Cortex licenses, whereas AMR11 family you've done about 70, would you say at this point that, going into 2009, that Cortex is a more well-licensed processor and so there could be -- you're going to have a new family next year, or how do we look at the processor licensing pipeline into 2009?

Warren East - ARM Holdings plc - CEO

Sandeep, it's Warren. As we've said, when we take a snapshot of the pipeline at the moment, it looks relatively strong, notwithstanding the economic backdrop that's out there. And we're not really seeing an effect at the moment of the economic backdrop that's there.

Looking at Cortex family and comparing it with ARM11, we would always expect the Cortex family to eventually grow to be larger in numerical terms, because we're spanning multiple application points. At 49 licenses right now, interestingly I was doing a bit of research here and at the corresponding point for ARM11, when ARM11 reached 49 licenses, that was about a year further into the ARM11 history than the 49 licenses which are now there for Cortex. So, so far, the behavior has been pretty much in line with expectation, i.e., Cortex licenses faster than ARM11 because it's targeting a wider range of applications.

As we go into next year, yes, there will be additional product being released during the year. But an earnings conference call is not the time to be announcing new products, so we're not going to talk about any details on those right now.

Sandeep Deshpande - JP Morgan - Analyst

And finally, Warren, regarding what your customers are saying at this point, overall, their feeling on their R&D expenses or whatever, whether they capitalize some of these costs associated with their licenses, whether they are, given the current economic environment, they are willing to sign on the dotted line despite what is happening in the market and how do you see '09? Is this because of this pipeline that you feel slightly confident about '09, or do you think that things could change further in the next couple of months?

And, further to that, have you seen changes the last six weeks, as many semiconductor companies have?

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Warren East - ARM Holdings plc - CEO

Well, we have certainly, since the industry returned to work from its summer holidays, if you like, we have seen exactly the same signs as everybody else has, which is a growing uncertainty over consumer expenditure, a growing caution in terms of managing inventory, and in some cases some very tight management of inventory.

However, as always, the decision to license an ARM microprocessor core needs to be taken in a much longer-term context. And what we're seeing across the bulk of our semiconductor partners at the moment is that they're being very wary about the short-term trading conditions, but recognizing that they've still got a business to run beyond any economic cycles. And products have to be developed, and some of those products need to use new microprocessors. And so our discussions with the technology folks about licensing new microprocessors are proceeding in the normal way. But nobody can possibly ignore what's going on in the wider world from an economic point of view.

Sandeep Deshpande - JP Morgan - Analyst

Thank you very much.

Operator

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

Didier Scemama - RBS - Analyst

Yes. Good morning, gentlemen. Thanks for taking my question. I just I'd like to go to PIPDs. It seems like you're making good progress with, again, the same Tier 1 [IDM], I guess, taking your fourth consecutive quarter, STM taking Mali -- sorry, taking PIPD license at 40 nanometre. But still, your PIPD licensing business was a bit weak, so maybe can you reconcile that? And I have a follow-up.

Warren East - ARM Holdings plc - CEO

Yes. Well, I think the reconciliation is pretty much as Tim described it. Where we're seeing a lot of the activity that we're talking about is at the leading edge where revenue will be recognized over multiple quarters in 2009 and beyond. This is advanced geometry stuff. And that is where the focus of our sales activity has been because, as you know, it's been the focus of our engineering activity for the last couple of years. And now we want to put that into practice commercially, and so that's where the sales emphasis has been.

As it happens, the shortfall in license revenue during the quarter is effectively made up with literally one or two deals, and I did mention that the backlog overall had returned to flat levels in the opening weeks of the quarter. And some of that is certainly to do with Physical IP licenses, which have been sold so far in Q4.

Didier Scemama - RBS - Analyst

Yes, perfect. That makes complete sense. I'm just also wondering if you would dare to make a forecast for 2009 number of ARM core per mobile phone, so for next year. If I look at the underlying market for Smartphone, it looks like their proportion of the percentage of the total market is creeping up; I think, about 16% to 17% of total handsets could be Smartphone next year. So I'm just wondering if you would dare to make a prediction of the number of ARM cores into '09.

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Warren East - ARM Holdings plc - CEO

It's very hard for us to see where that's going to finish up, obviously, Didier, but we see exactly the same as you are; that a) the Smartphone proportion is creeping up and going to continue to do so. And that's why I said a few moments ago in my opening commentary. But also, we are seeing increased numbers of phones with Bluetooth. That's one of the drivers of volume in the recent quarter, and mobile phones is an area that is a key driver for that.

So I wouldn't be at all surprised if we got into the two cores per phone range, but right now it's still about [1.7]. And the number of low-end phones is probably -- when times are hard, the number of low-end phones is -- people are going to sell cheaper phones as well as expensive phones. So it's very hard for us to predict how far it's going to go. Actually, Tim's prompting me that the latest number is [1.8] per phone, but could easily be two in 12 months' time.

Didier Scemama - RBS - Analyst

Okay. Many thanks.

Operator

Your next question comes from Nick Gaudois from UBS. Please ask your question.

Nick Gaudois - UBS - Analyst

Yes, hi. Good morning. First question is bigger picture licensing. If I think back about the last cycle, your licensing revenues dropped more than 12 months after your overall semis revenue growth started to decline. So we see was a very late cycle nature in the licensing business model. Now there are obviously a lot of changes in the model from where we were in 2002; your product portfolio is much, much broader, in particular. So could you share your view on how you see the licensing model developing next year, taking as an assumption for now that semis revenues will be down next year? Thank you.

Warren East - ARM Holdings plc - CEO

Actually, Nick, we see the trend in license revenue, but I think when we had this call or did the presentation a quarter ago, we talked about the middle quarters of 2007 as being unusually high. And we talk about, at the moment, the normal range for ARM processor license revenue is in the \$35 million to \$40 million per quarter range, and that's where we see it at the moment. We've talked about medium-term growth trends there being in the 5% to 10% range, and fluctuations being driven, primarily, by product cycles. And I think that the fluctuations in ARM's license revenue are much more driven by product cycles than by semiconductor industry cycles.

Obviously, we can't ignore what's going on in the industry at large, but that seems to be that the drivers behind the actual licensing that we do in a quarter. And every now and again we'll get a quarter where we exceed the \$40 million, just as last quarter we had a quarter where license revenue was below the \$35 million. But that is the normal range for the time being.

Nick Gaudois - UBS - Analyst

Okay. Just a second question would be on royalties for Processor business. If you look at some of the details, there were some surprisingly strong numbers there but, in particular, in non-mobile phone wireless, I suspect in networking, in consumer as well. So considering again the environment which for Q2 '08 [shipments] for industry was okay but not necessarily fantastic, could you give us a little bit of help on why we may have seen a significant increase in ARM penetration in some of these markets?

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Warren East - *ARM Holdings plc - CEO*

Well, this is just a continuation of the increasing penetration that we have been seeing for some years now. And, if you look back over recent quarters of licensing activity, we've talked about an increasing number of the licenses being purchased with the first targets being outside of mobile. We've put, for the last several years, a lot of design-in effort into segments outside of mobile, and so what we're seeing is absolutely what we'd expect to see in terms of growth outside of mobile.

I recall some of the recent presentations we've done at these conferences where we've put up a number of people licensing Cortex M3 for microcontrollers. It's a measure of the activity of the semiconductor world in ARM-based microcontrollers. Eventually, if these companies' plans are successful, then that shows through in ARM royalty.

Nick Gaudois - *UBS - Analyst*

Okay, great. And last question would be on PIPD royalties. If we take out the catch-up royalties we had, about a 14% sequential decline in dollar terms in Q3 versus Q2 there, that seems to be maybe a little bit ahead of what we saw in terms of wafer start-up at foundries in Q2. So maybe could you help us reconcile what happened there versus [the backdrop of] industry.

Tim Score - *ARM Holdings plc - CFO*

Well, I think, Nick, if you look at the -- over the year since we've owned this Physical IP business, you can often see some relationship between overall foundries and the PIP royalty number. But in reality, because we're dealing with a relatively small number and the devil is in the detail about which nodes are generating the royalties, I think it's sometimes quite dangerous just to assume that the overall utilization levels across all of the nodes translates into Physical IP.

I think what you've seen throughout this year is a reflection that, as what Warren referred to, which is over the years, an increasing use of Physical IP from ARM. And, of course, this is increasing use based on the technology largely that we acquired a few years ago that's being increasingly used. Most of the licensing activity we've been talking about today, and in recent quarters, obviously hasn't yet generated royalties. So what you're seeing is a generally increased underlying usage of ARM technology Physical IP, but still somewhat related to industry utilization.

Nick Gaudois - *UBS - Analyst*

Okay. Thank you very much.

Operator

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

Simon Schafer - *Goldman Sachs - Analyst*

Yes, hi there. Thanks. I was wondering, just in terms of the cost base of the business and what the flexibility is on the headcount side, I guess you're also saying that, clearly, the world has changed a little bit. I know you get an advantage from the currency change right now, but if things were to really take a more material slowdown, how aggressive will you show yourself in terms of managing the cost base?

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Tim Score - *ARM Holdings plc - CFO*

Simon, hi, it's Tim. We're, like a lot of businesses, going through the budget cycle for next year at the moment, and I think it goes really without saying that there is a greater degree of uncertainty as to businesses' top lines next year than normal. Therefore, we are looking at our cost base next year across a range of potential outcomes.

Our goal will be to invest in the long-term health of this business. If we have to moderate the pace and extent of hiring then we will; you've seen us do that in recent years. But we go into it with our general intention to grow costs at no more than half the rate of revenues. If we find that 2009 is a very tough year then we will manage costs more aggressively, as we have done recently. But what we're trying to do here is build the trajectory of the business for growth in the medium to long term, but we're very well aware of short current conditions.

And, of course, we do actually have a lot of flexibility because the costs we incur now are really aimed at royalties out into the future. And so we have some good levers on that and we can react, but we don't really want to be chopping and changing. We want to be building a steady trajectory for growth.

Simon Schafer - *Goldman Sachs - Analyst*

Understood. But under a scenario whereby revenues could be down next year, would the decline in the cost base be half the pace of that decline, or how will you looking at the flexibility if the revenue run rate goes down?

Tim Score - *ARM Holdings plc - CFO*

I don't think you can apply a formula like that. To be honest, I don't think would be sensible, but we do have levers. We have pretty much -- most of our cost base is, obviously, it's a people-related thing. And we've shown in recent years, you're going to -- you've seen periods like 2006 where we had significant investment, you've seen periods which are, basically, since then where our headcount has been broadly flat. And we've been doing things like building up design centers in lower cost areas. So we will do what we need to do.

We're looking at a range of possible outcomes for next year. But, as Warren said, we go into the fourth quarter and into 2009 with ARM in pretty robust shape, and well positioned to deal with what the market throws at us, and we do have flexibility in our cost base.

Simon Schafer - *Goldman Sachs - Analyst*

Great. Thanks. And my second question would -- well, it's very similar actually to the questions that have been asked before so I apologize. But just from a licensing activity going forward, what's the segment that you're most excited about from a 12-months' point of view? Is it graphics or is it still mobile, or non-mobile? Some type of color as to -- just because the question, obviously, being that now that Cortex is, well, perhaps not past the sweet spot of real S curve growth, but if and when that might see a bit of a tailing off, what else is there to pick up the slack?

Warren East - *ARM Holdings plc - CEO*

I think the question, when we talk about applications and the exciting things for the next 12 months, we would stick with exactly what we've talked about before, which is microcontrollers and Smartphones. And for Smartphones, I probably mean the mobilization of the Internet, and those of the sort of applications that demand Cortex A-8s and Cortex A-9s and microcontroller, the Cortex M-3s.

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Now quite a lot of the licensing activity for microcontrollers has happened, although, as I said in the presentation and the halfway point in the year, we expect more Cortex M-3 licensing during this year and into 2009.

Those are really the two key application areas, it's the microcontrollers and the mobile computing, and the latter is high end processor licensing, and the former is specifically aimed at microcontrollers.

Simon Schafer - *Goldman Sachs - Analyst*

Great, thanks Warren.

Operator

Your next question comes from Francois Meunier from Cazenove. Please ask your question.

Francois Meunier - *Cazenove - Analyst*

Can you hear me?

Warren East - *ARM Holdings plc - CEO*

Yes.

Francois Meunier - *Cazenove - Analyst*

Yes, sorry, just a question about the cash, do you plan to do a bit less buybacks next year just in case? Maybe the GBP50 million is quite comfortable, but just in case to slow down this.

Warren East - *ARM Holdings plc - CEO*

Yes, the buyback program that we introduced in July 2005 is an ongoing program. And I think, like every other aspect of our business, it will bear in mind the overall environment that we find ourselves operating in. So we will see, but we have an intention of continuing that program.

Francois Meunier - *Cazenove - Analyst*

Right, okay.

Warren East - *ARM Holdings plc - CEO*

No specific guidance to be given at this stage. Probably, like we did at the beginning of this year, when we talk about our full year results at the end of January/beginning of February next year, we will update a more medium-term view of the capital structure in the balance sheet. But we would see the ongoing buyback program as an integral part of managing our capital structure.

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Francois Meunier - *Cazenove - Analyst*

Okay, basically I understand you're doing your budget for next year but what could be a worse case scenario for the top line development in dollar terms next year? Are you even thinking about minus 10%, minus 15%?

Warren East - *ARM Holdings plc - CEO*

Well first of all, we absolutely keep our eyes and ears open. We talk to the industry at large and we can see what's going on. However, we don't actually expect overall revenues to decline in 2009 from 2008.

And I think that's about as far as we would really want to go right now in terms of talking about where we expect things to end up. Qualitatively we've talked about a robust opportunity pipeline; we know that licensing sales cycles are three to 12 months. And so the fact that we're talking at the end of October does reflect what goes on into 2009 from the licensing perspective. We're talking about momentum in terms of market share gains across a wide range of applications driving royalties and we would expect those market share gains to continue on the sort of trajectories that they are at the moment.

And those market share and licensing momentum structural issues we expect to have an offsetting effect to any macro situation that we may experience. But obviously, as with any business, we have to be a bit careful at the moment and it's too early to be very specific about our numbers for 2009.

Francois Meunier - *Cazenove - Analyst*

Okay, thank you.

Operator

Your next question comes from James Crawshaw from Singer Capital. Please ask your question.

James Crawshaw - *Singer Capital - Analyst*

Thanks very much, just some housekeeping questions really. The restructuring charge of GBP395,000 in PIPD, are there any more restructuring charges we should expect going forwards?

Tim Score - *ARM Holdings plc - CFO*

No short-term expected restructuring charges.

James Crawshaw - *Singer Capital - Analyst*

Great, I just noticed in the balance sheet goodwill seems to have risen sequentially. I'm not aware of any recent acquisitions. What was the driver behind that?

Tim Score - *ARM Holdings plc - CFO*

That's basically FX because it's essentially a dollar denominated asset and if you look at the exchange rate end of Q3 versus end of Q2, obviously significant strengthening.

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James Crawshaw - *Singer Capital - Analyst*

Fine thanks. And similarly deferred, well not similarly, deferred revenue is down both sequentially and year-on-year. Is that FX related?

Tim Score - *ARM Holdings plc - CFO*

No that's more just to do with the lumpiness of how deals get booked into deferred revenue and come out.

I think if you're looking at the overall shape of the balance sheet, one of the interesting contrasts to draw I think is the fact that now amounts recoverable on contracts, which are the sort of equal and opposite of deferred revenue, is significantly less than deferred revenue, which I think is a pretty healthy measure. Because you probably heard me say a couple of years ago that if the amounts recoverable on contracts and deferred revenue were tracking fairly equally then that's about par. So if amounts recoverable on contracts is less than deferred revenue, that's reasonably healthy.

Deferred revenue is jumped around in a fairly predictable band from quarter to quarter and it's just deals coming in and out of deferred revenue as the revenue becomes recognizable.

James Crawshaw - *Singer Capital - Analyst*

Okay, fine, and finally then, just so we're all singing of the same hymn sheet, what exactly is the fourth quarter revenue expectation in dollars?

Tim Score - *ARM Holdings plc - CFO*

The revenue expectation for the fourth quarter, as of today, is somewhere in the [\$137 million/\$138] million range.

James Crawshaw - *Singer Capital - Analyst*

Fantastic, thanks very much.

Operator

Your next question comes from Lee Simpson from Jefferies. Please ask your question.

Lee Simpson - *Jefferies & Company - Analyst*

Hi, good morning gentlemen.

Ian Thornton - *ARM Holdings plc - Director IR*

Good morning.

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Lee Simpson - *Jefferies & Company - Analyst*

If we accept the point that I think you're making that the product cycles for ARM are more influential next year in the licensing than the industry cycle, can you actually then maybe try and give us an idea for what the degree to what the industry cycle may be influential? Will we see Tier 2s taking term deals? Is there going to be a change in the nature of licensing next year that you anticipate? I wonder if you can maybe comment on that first.

Warren East - *ARM Holdings plc - CEO*

Yes, I'll comment on it. Certainly we would expect business to be hard for us in terms of licensing if business is hard for the customers who are licensing from us. But as I said in answer to the earlier question, the licensing decision is normally taken with a much longer-term view than one takes when dealing with the short-term trading environment.

And it's very similar to the sort of question that Tim was answering just a moment ago in terms of how we control our own costs. Yes, the company needs to control costs for the current period but we have to develop a roadmap for the future, so do our customers.

Now the experience that we have had over the last 10 years or so where we've seen industry cycles rather than wider economy-driven cycles is that licensing tends to be somewhat insulated from those cycles.

And back in 2002, when the semiconductor revenues had been down off a peak some 40% for a very long period of time, we did see ARM's licensing activity adversely affected by the conditions that our customers were experiencing. But actually, since that time, during the more normal semiconductor cycles, we haven't actually seen our licensing hugely affected by those cycles.

As for what's going to happen with this cycle, it's very hard for us to call, just as it is for you guys. But what we can see is that the current falling of growth in the semiconductor industry, and expected growth for the semiconductor industry next year, is more like the sort of order of what's gone on recently industry-driven cycles than what went on between 2000 and 2002. And those are the facts that are before us, exactly the same as everybody else can see.

Lee Simpson - *Jefferies & Company - Analyst*

Alright, great, maybe just one or two sort of house questions again as well. What were the actual shipments for PD royalties? We didn't get an actual number this time. You said 1 billion but --

Tim Score - *ARM Holdings plc - CFO*

One billion.

Lee Simpson - *Jefferies & Company - Analyst*

Okay.

Warren East - *ARM Holdings plc - CEO*

It's a very round number.

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Lee Simpson - *Jefferies & Company - Analyst*

Yes exactly, and service revenues look like they're down quite a bit. I don't know if anyone's asked already, was there anything behind that?

Warren East - *ARM Holdings plc - CEO*

The service revenue is quite heavily related to current year licensing, and current year licensing has been down. You saw us do a down quarter in Q2 and normally that Q2's licensing revenue would help to boost service revenue in Q3. And it didn't this quarter because licensing was down in Q2.

Lee Simpson - *Jefferies & Company - Analyst*

Right.

Tim Score - *ARM Holdings plc - CFO*

I think, Lee, if you look back over the last sort of eight or 10 quarters, you'll find that it moves around in the \$7.5 million to \$8.5 million a quarter range and I think this \$7.7 million is at the lower end and Q2 at \$8.4 million was at the higher end, but I think it's in that band.

Lee Simpson - *Jefferies & Company - Analyst*

Fair enough, and maybe something about the cash expansion again. You're up to GBP66 million. Are you moving in line now more comfortably with any changes in the OpEx base you're within, or is it a nod towards inventory management? And can you give us an idea as to what may change your capital thinking in the short to medium-term with regards to cash piles?

Tim Score - *ARM Holdings plc - CFO*

To be honest, I don't think there's a dramatic change. We said we're happy with running with a cash balance of GBP50 million plus. We happen to be over GBP60 million at the end of Q3 but there's no real change. The facts are, as you can see from the last two quarters, that the free cash flow generation of this business is on an upward trend as the royalties grow and, therefore, you're going to see more capital structure management, more balance sheet efficiency. So I don't think it's a change in policy.

As I say, beginning of next year, we will probably give some more specific guidelines and targets about the medium term, just to help you think about it. But at the moment is GBP50 million plus but no plans to rebuild a cash pile.

Lee Simpson - *Jefferies & Company - Analyst*

Great. Maybe one final question, the dollar component in general and admin, can you maybe give us an indication of what that is?

Tim Score - *ARM Holdings plc - CFO*

It's broadly a half of our overall costs.

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Lee Simpson - *Jefferies & Company - Analyst*

Right, but in admin you can't say what it is. Is it higher there?

Tim Score - *ARM Holdings plc - CFO*

No, to be honest, the general and admin costs is the one area that includes more of the non-staff costs and therefore it tends to fluctuate around more quarter to quarter. But in terms of modeling, I wouldn't think of it differently than broadly half.

Lee Simpson - *Jefferies & Company - Analyst*

Right, great, thanks very much.

Operator

Your next question comes from Paul Morland from Blue Oar. Please ask your question.

Paul Morland - *Blue Oar Securities - Analyst*

Hi, my question was also on that G&A line. Is the hedging charge in the G&A line?

Tim Score - *ARM Holdings plc - CFO*

Yes.

Paul Morland - *Blue Oar Securities - Analyst*

Okay and can you just give a little bit of guidance on -- I understand it does jump about, but what might happen there in Q4?

Tim Score - *ARM Holdings plc - CFO*

Well the way the hedging works, as I think most of you know, it's an ongoing hedging program where we tend to take out layers of hedging with a view to covering a quarter or two quarters ahead. Now obviously in a period where you've had a sharp move in the currency, like we had from the end of July through to the end of September and like we've had in Q4, if you're taking out those contracts, forward contracts for example on an ongoing basis, you're bound to have some contracts out of the money. And therefore, when you mark them to market at the end of the quarter, you're likely to have a fair value loss like we had in this quarter, rather than the credit in the quarter before.

But unfortunately, you don't really know the final answer until you know what the exchange rates are on the last day of the quarter, which is obviously the key. But if we stayed in the [\$1.50s] then you would expect in Q4 that the net impact of accounting for those type of instruments would be a debit again rather than a credit, but that could change.

If you look at it from the nine months to date, you're talking about a less than GBP1 million impact in the nine months. So although it is potentially more volatile in -- let's face it, we've just been looking at two fairly extraordinary quarters, Q3 and Q4 to date. In most other quarters, yes it goes between a few hundred thousand either side but not dramatic. But we're living in slightly unusual times at the moment.

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Paul Morland - *Blue Oar Securities - Analyst*

But it's the period and rate that matters there rather than the average rate in terms of marking it to market and the hit that you take in the quarter?

Tim Score - *ARM Holdings plc - CFO*

Yes, the things that matter are, exactly what contracts have you got outstanding at the end of the quarter and at what rates were they taken out, and how do they compare to the period end rate? That's essentially the equation and therefore, until you get to the end of the quarter it's hard to call. But based on how it's been tracking, it would be reasonable to expect that the impact in Q4 will be a net charge, like it's been in Q3 because of the significant further strengthening that's occurred since the end of September.

Paul Morland - *Blue Oar Securities - Analyst*

Okay, thanks.

Operator

Your next question comes from Clara van der Elst from Standard & Poor's. Please ask your question.

Clara van der Elst - *Standard & Poor's - Analyst*

Yes, hi good morning, I have a question on the competitive landscape with Intel. How do you see that evolving?

Related to that, do you see any significant new opportunities outside mobile handsets?

Warren East - *ARM Holdings plc - CEO*

Well obviously we've seen a lot of press discussions over the last 18 months about Intel and ARM and it's true that the sort of functionality that one gets today in a high-end Smartphone, possibly with something like an ARM11 in it, is very similar to that which you can get with a low-end PC. And that is coincident with a push from Intel in terms of marketing on mobile Internet devices and, if you like, low-end notebook PCs means that there is a grey area in between these two product categories where the main processor could be something like the ARM processor in a Smartphone or could be something like an X86 processor in a notebook PC.

The reality is that you can get a very good Internet experience with an ARM11 today. We're spending a lot of time and effort in the ARM ecosystem, working with software partners, applications providers and so on, with a view to enhancing that Internet experience. And products like the Google Android phone just recently launched demonstrate some of that capability. I think over the next 18 months, you're going to see plenty of new low-end PCs launched based around Intel Atoms, and you're going to see some similar products based around some Cortex A8 ARMs. And I would point out that both Intel and ARM have roadmaps to improve the performance and power consumption of their processors going forward, and it's going to be an exciting competition.

Right now, in terms of power consumption at equivalent levels of performance, then the ARM processors have a tremendous lead over Atom, and the ARM camp is, of course, not just the ARM Company, but the likes of Qualcomm, Samsung, Infineon,

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Texas Instruments, and so on, who are all very active in this area, and have been so for the last many years, based on the ARM architecture.

Clara van der Elst - *Standard & Poor's - Analyst*

Okay. And I think there's been industry speculation on a co-processor role. Is that something you could discuss?

Warren East - *ARM Holdings plc - CEO*

I'm not really sure what type of product you might be talking about. I think there are, certainly, some people who are thinking about products using both ARMs and x86s in different [sockets]. I would stress that, if you go and buy a notebook computer today, yes, the main processor is an Intel processor, but there's probably a fair number of ARMs in there as well, in Bluetooth and WiFi and hard discs and so on, and these electronic products are vehicles for multiple microprocessors.

Clara van der Elst - *Standard & Poor's - Analyst*

Okay. Thanks a lot.

Operator

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

Didier Scemama - *RBS - Analyst*

Yes, just wanted to understand one thing. Maybe, Tim, if you could comment on the amount of your backlog for licensing that is going to be basically recognized, effectively, over the course of calendar year '09. How much of that is coming in?

Tim Score - *ARM Holdings plc - CFO*

Well, if you look at the slides, Didier, that we put up there, there's the normal maturity profile there which gives you next two quarters, the following two quarters, and then life beyond four quarters. So you can get a pretty good feel by looking at the first two there, for what we expect over the next four quarters, and then make an assumption about the last quarter, the fifth quarter, as it were.

Didier Scemama - *RBS - Analyst*

Yes, but I was just wondering if you could maybe be a bit more explicit, because we obviously don't see that in hard numbers?

Tim Score - *ARM Holdings plc - CFO*

What would you like me to -- what sort of things would you want to know?

Didier Scemama - *RBS - Analyst*

Well, roughly speaking, the amount of backlog.

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Tim Score - ARM Holdings plc - CFO

Well, I think you've probably got your own estimate of what our backlog is, and therefore if you apply the percentages that are in those pie charts, then -- I think the reality is, as we've said, the order backlog is at very close to its historic high levels, and therefore it's a good underpin for the fourth quarter and going into 2009. And those charts give you our best estimate based on projected engineering activity of how that backlog translates into recognizable revenue. But the precise number will depend on, effectively, your forecast of order backlog, because, as you well know, we don't give the absolute number.

Usually, coming into a year, we would have somewhere between 40% and 50% of target license revenue covered in opening backlog. And sitting here today, we don't really see any particular reason why that would be different going into 2009, based on expected Q4 activity on top of the current backlog, which, as Warren said, is already moving in a good direction through Q4.

Didier Scemama - RBS - Analyst

Yes, that's helpful. And two quick questions, with regards to mix for PD royalties in '09, it's great that you've given us more details on ARM7, ARM9, ARM11, and so on. I'm just wondering, should we expect a little shift towards ARM9 and maybe even ARM11 being more pronounced in total weight of PD royalties, number one?

And second, I don't know if you mentioned the assumption for the sterling rate in the fourth quarter?

Warren East - ARM Holdings plc - CEO

On the royalties, going forward, then we would expect ARM11 to follow the same sort of trajectory as ARM926 and ARM9s more generally. As I mentioned, we've moved to 3% at the moment, so during the next 12 months, I'd expect that 3% number to at least double as a proportion during the year.

Tim Score - ARM Holdings plc - CFO

Didier, in terms of the effective rate for the fourth quarter, I think it's reasonably fair to say that your guess will be as good as mine. The issue is that our effective rate on the top line will be the weighted average rates at the dates we invoice through the quarter. The only rider on that would be that to the extent revenue is contributed from the deferred revenue balance at the beginning of the quarter, then that will be recognized in the P&L at the rate into which it was booked into deferred revenue.

So, obviously, our deferred revenue balance has some exchange rates that are a few months old, when the dollar was a bit weaker. But basically, I think you just have to make -- who knows where it's going to go from the \$1.55/\$1.56 we are today. If it stayed where it is today for the rest of the quarter, then the chances are our effective rate, given what I've said, could well end up in the \$1.60/\$1.65 area.

Didier Scemama - RBS - Analyst

Yes, okay. Many thanks.

Operator

Your next question comes from Robert Sanders from Dresdner Kleinwort. Please ask your question.

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Robert Sanders - *Dresdner Kleinwort - Analyst*

Yes, I just managed to sneak in there. Most of my questions have been asked, but maybe just a quick question on WiMAX. Intel appears to be pushing WiMAX quite aggressively, and next year. I know you guys collect a royalty on that chip, I was just wondering if you thought that might be meaningful in 2009?

Warren East - *ARM Holdings plc - CEO*

Well, clearly it will be a positive driver. But I think if you look at the overall volumes there, then it's pretty small. Next year we would expect volumes to continue to increase. This year we're on track to do more than 3.5 billion units, and we're talking about single-digit millions for WiMAX. So it's a very nice positive contribution to ARM's royalty, but I don't think you'll really notice it in the overall numbers.

Robert Sanders - *Dresdner Kleinwort - Analyst*

Okay. And just on the Mali deal with STMicro, can you just confirm that was for the ABS processor? Have you effectively dislodged ATI for that deal, and given ATI seems to be pulling out of that business, is that part of the reason why you are confident on the prospects for graphics? Thanks.

Warren East - *ARM Holdings plc - CEO*

Actually, we're confident on the prospects for graphics because we're confident on the prospects for graphics. As far as specific customers are concerned, we really only talk about things when they want to talk about them, and right now, ST aren't ready to talk about their detailed product plans for the use of our graphics technology. It's generally in (inaudible) and mobile applications. As and when they have specific products, we'll let ST talk about them.

Robert Sanders - *Dresdner Kleinwort - Analyst*

No problem.

Operator

Your next question comes from Robert Owens from Cazenove. Please ask your question.

Robert Owens - *Cazenove - Analyst*

Hi. I have just another question on the exchange rates, I'm afraid. You previously had guidance, or a rule of thumb rather, for about a 1.5% to 2% change in EPS, given a 1% change in the effective rate. Is there any reason why that would change, or we should think of it any differently, given the volatility in the exchange rate?

Tim Score - *ARM Holdings plc - CFO*

Not really, no. That's a reasonable rule of thumb.

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Robert Owens - *Cazenove - Analyst*

Okay, perfect. That was it, thank you.

Tim Score - *ARM Holdings plc - CFO*

Thanks.

Operator

Your next question comes from Michael Blogg from Arbuthnot.

Michael Blogg - *Arbuthnot - Analyst*

Yes, good morning. A couple of questions, actually. The first is going back to Warren's, I think, fairly reluctant comment about the outlook for overall revenues in 2009. I'd just clarify that you were talking about dollar revenues rather than the sterling numbers?

Warren East - *ARM Holdings plc - CEO*

Yes, I was.

Michael Blogg - *Arbuthnot - Analyst*

Yes, okay. And some financial questions for Tim. The first is, are you convinced there's an economic benefit to the hedging that you have in place?

Tim Score - *ARM Holdings plc - CFO*

I don't think we'll get into theoretical arguments about that, but we certainly think it's appropriate to have some level of certainty, at least over a couple of quarter view.

Michael Blogg - *Arbuthnot - Analyst*

Okay. Looking at the balance sheet, the short-term investments, you've put about GBP10 million into that line in the last quarter. What actually are the instruments you're putting cash into?

Tim Score - *ARM Holdings plc - CFO*

Those are just more to do with the length of deposit.

Michael Blogg - *Arbuthnot - Analyst*

Okay. And then finally, also on the balance sheet, the other intangible assets seems to be moving down at a fair rate of knots. Can you tell us what that's about? Is it presumably patents and licensing, in that line?

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Tim Score - ARM Holdings plc - CFO

Yes. I think, as you know, Michael, when you do acquisitions, you have to split what was the good old-fashioned goodwill between traditional goodwill and other identifiable tangible assets, and the goodwill sits on the balance sheet and is subject to regular impairment reviews, whereas the other intangible assets are written down over the average weighted lives of those assets. Most of those other intangible assets relate back to the Artisan acquisition, where I think you may recall, that they were being written off over five to six years. So that's why you're seeing an amortization of intangibles of circa GBP4 million a quarter each quarter, and that's why they're going down.

Michael Blogg - Arbuthnot - Analyst

Okay. Thanks very much, Tim.

Tim Score - ARM Holdings plc - CFO

Thanks.

Ian Thornton - ARM Holdings plc - Director IR

We'll take questions from one more person, please.

Operator

Your next question comes from Sandeep Deshpande from JP Morgan. Please ask the question.

Sandeep Deshpande - JP Morgan - Analyst

Hi. Thanks for letting me on again. Warren, just with regards to your comment, a bit reluctantly, about '09 that you expect that the revenue will be flattish, given that the foundry utilization is already at about 60% or close, and given what the outlook is, it would mean that you are expecting a substantial increase in market share in terms of your units shipped in 2009, or that you expect that your licensing is going to grow very substantially in 2009? Can you reconcile one of those?

Warren East - ARM Holdings plc - CEO

I don't think I was specifically talking about foundry utilization and designs. We know that across the piece of our processor activity and our physical IP activity, we're enjoying many new tape-outs each year, and growing market share. I was simply responding, a minute or two ago, to the hypothesis that revenue could significantly decline in 2009, and simply saying that, from where we sit today, we absolutely do not expect to see revenue decline in 2009. Really, the intent of my comment was simply to put a floor under that sort of discussion.

Absolutely, we can see what's going on in the industry, and we can see that people are heading for difficult times. But our experience over recent years, through recent semiconductor cycles, is such that licensing continues to happen, albeit perhaps at a slightly muted rate, and our market share continues to drive increases in royalty. So that's it, I'm afraid.

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Sandeep Deshpande - JP Morgan - Analyst

So, is this -- are you making a call on the second half of '09, rather than what's happening at this point?

Warren East - ARM Holdings plc - CEO

No, I'm not making a call on any specific period in '09, I'm simply looking at the market share positions that we have at the moment, the design-ins that exist in the pipeline, and making a call on the rate of growth of ARM's market share. Don't forget, we're just reporting a quarter with volumes up, on average, 45% across the segments; mobile up 40%, enterprise up 60%. And we are looking at semiconductor industry forecasts, which are actually all over the place at the moment and have been coming down, but are in the single digits of percentages growth, either positive or negative. And so I'm saying that we don't expect to see revenues decline.

Sandeep Deshpande - JP Morgan - Analyst

Okay, thanks.

Warren East - ARM Holdings plc - CEO

Simple as that. So, Ian said that was the last question, so I'll quickly summarize. So we're just reporting Q3. We're very pleased with Q3. It's the highest quarterly revenue that we have yet reported, up 7% at \$134.5 million. We've set another milestone with 1 billion ARM microprocessors shipped. There's some very good activity in our Physical IP division with some long-term strategic deals signed at the beginning of the quarter and at the end of the quarter, pushing on 32 nanometer and 28 nanometer technology. Back within the operation, we've had good continued cost control, and that combined with the initial effects of the strengthening dollar have contributed to increases in profits, earnings per share, and operating margin, and that's enabled another good quarter of strong cash generation.

Looking forward, the business is in good shape going into Q4. The license pipeline is certainly as robust as it was. We have a backlog which is back to the high levels that it was in the middle of the year. Royalty momentum is strong; initial indications from the semiconductor companies from early royalty indications are very promising for the coming quarter. And we continue to be very well placed to benefit from the further strengthening that's happening in the US dollar, as Tim has been discussing.

And with that, we'll be back in the beginning of February to talk about our Q4 results. Thank you very much, everybody.

Operator

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

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