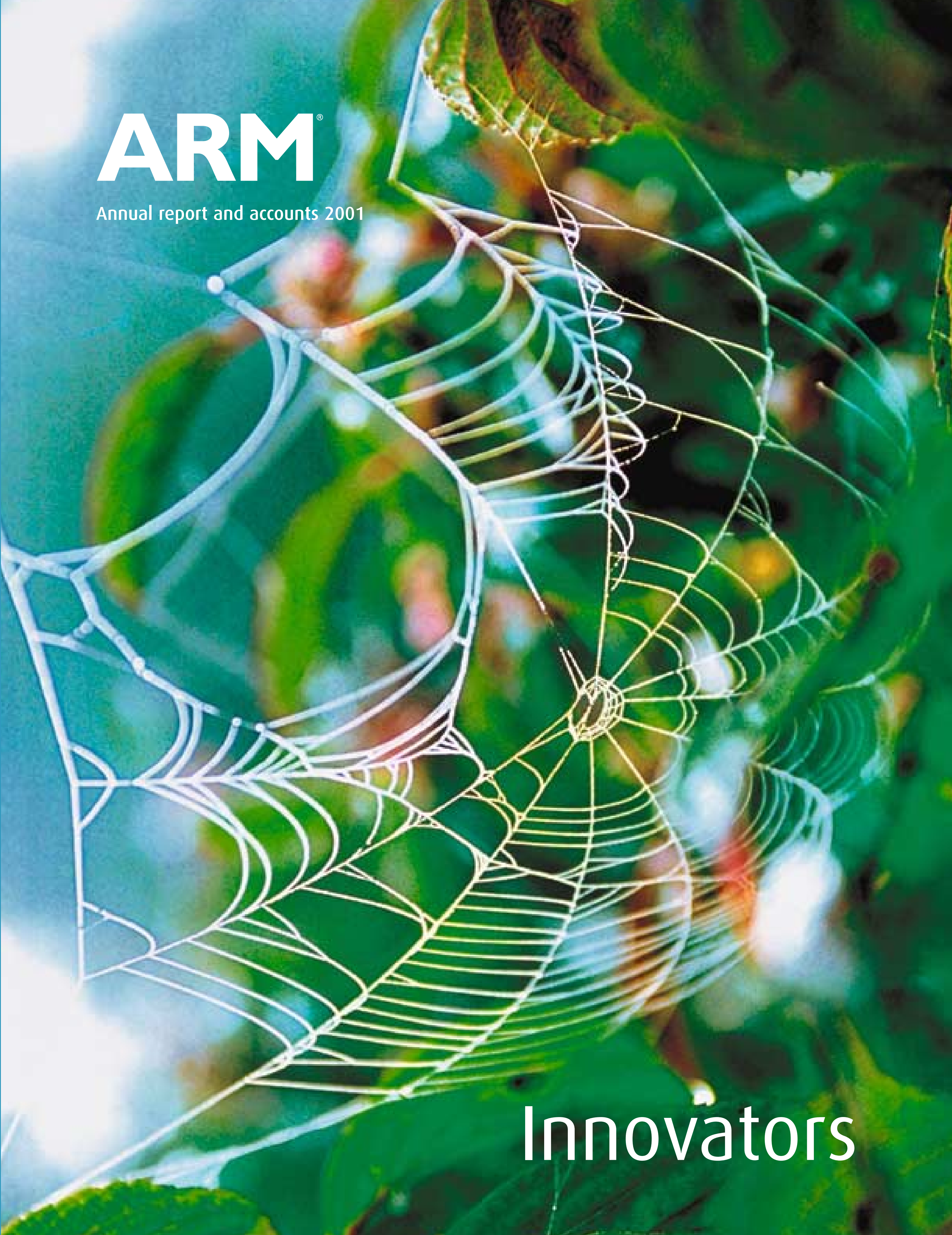
ARM®

Annual report and accounts 2001



Innovators

Contents

ARM

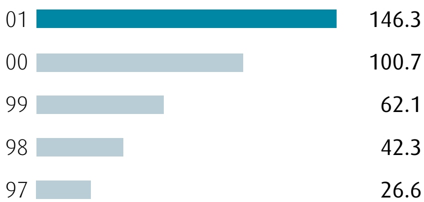
ARM licenses innovative, power-efficient RISC microprocessor cores, peripheral solutions and system-on-chip designs to the world's major electronics companies. These are used in a wide range of applications, including those in the automotive, consumer entertainment, digital imaging, mass storage, networking, security and wireless industries.

As the world's leading provider of 16/32-bit embedded RISC microprocessor solutions, ARM's presence in the industry now encompasses more than 75% of the market. Our architecture is set to become the technology of choice for digital products worldwide, as old 8-bit applications migrate to 16/32-bit.

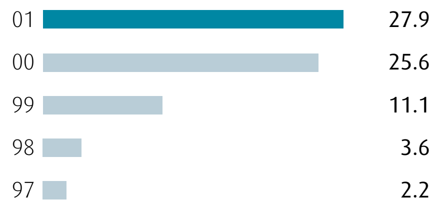
If you use a mobile telephone, a personal organiser, watch digital TV or access the internet, you are likely to be using a product which has our technology at its core.

ARM at a glance

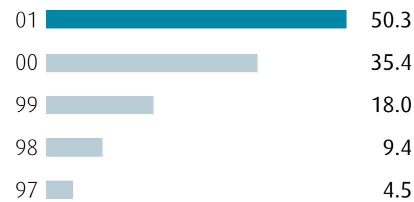
Revenues £m



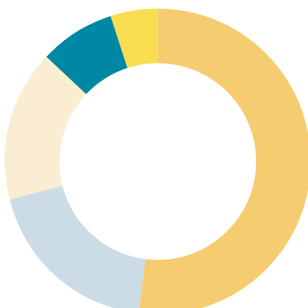
Royalty revenues £m



Income before tax (US GAAP) £m

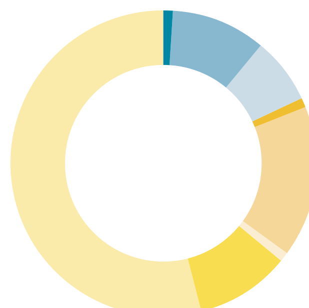


Revenue analysis %



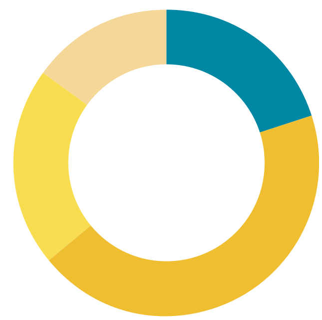
Licensing	52%
Royalties	19%
Development systems	16%
Support maintenance training	8%
Consulting	5%

Royalty revenues by end market % (est)



Automotive	1%
Consumer	10%
Imaging	7%
Industrial	1%
Networking	16%
Secure	1%
Storage	10%
Wireless	54%

Licence revenues by product %



ARM7™ family	20%
ARM9™ family	44%
ARM10™ family/architectures	21%
Non-core licensing	15%

Financial

- Revenue growth +45%
- Profit growth +42%
- Cash growth +39%

Geographical revenue by market destination

US 49%

Austin, Texas
Novi, Michigan
Carlsbad, California
Los Gatos, California
Northborough, Massachusetts
Redmond, Washington
Walnut Creek, California

East Asia 32%

Seoul, Korea
Taipei, Taiwan
Shin-Yokohama, Japan

Europe 19%

Blackburn, UK
Cambridge, UK
Maidenhead, UK
Sheffield, UK
Montigny le Bretonneux, France
Sophia Antipolis, France
Munich, Germany
Kfar Saba, Israel

highlights

- Development systems sales +71%
- Licensing revenues +69%
- Royalty revenues +9%

Chairman Sir Robin Saxby, left, with Chief Executive Officer Warren East.

2001 was another successful year for ARM, particularly in the context of a difficult economic environment and a severe downturn in the semiconductor industry. Revenue increased by 45% to £146 million and pre-tax profit grew by 42% to slightly over £50 million.

Licensing

The total number of our semiconductor Partners increased to 77 by the end of 2001, compared with 50 at the end of 2000. During the year, there was a clear trend towards our existing Partners taking "upgrade" and "derivative" licences for several cores at the same time, which helps increase their commitment to the ARM® architecture. For example, 27 existing Partners purchased 46 further products from us in total, of which 17 were classified as upgrade licences (defined as cores from a family different from that already licensed), and 29 derivative licences (defined as further cores in the same family already licensed). The ARM926EJ-S™ core, which incorporates our Jazelle™ technology, was particularly successful in 2001. Capable of running Java™ instructions up to eight times faster, it was licensed to 16 existing semiconductor Partners in little more than a year.

Of the 27 new licensees in the year, 18 were "per-use" licensees in our foundry programme, which we established in 2000 to provide smaller fabless companies with access to ARM technology, on a less expensive per-use basis, for manufacture with one of the three foundries that are part of the programme. We now have 25 such licensees.

Unit shipments and royalties

Unit shipments for the 12-month period, which ended in September (we receive data one quarter in arrears), grew from 367 million units in 2000 to 420 million units in 2001, an increase of 14%. Overall, ten new Partners began shipping in the year, bringing the total number to 33, compared with 23 in 2000. In 2001, the range of end markets using our technology broadened further to include the imaging (digital camera and printer) and secure (smart card) markets.

Development systems

The strong level of demand for development systems continued, with year-on-year sales up 71% to £23.3 million, compared with £13.6 million in 2000. The continued growth in the sale of development systems can be attributed to a number of factors. These include an improving range of development solutions available for sale, the establishment of a comprehensive distribution network with our tenth distributor recently appointed (compared with six a year ago), and continued growth in demand from East Asia,

2001 was another successful year for ARM, particularly in the context of a difficult economic environment and a severe downturn in the semiconductor industry. Revenue increased by 45% to £146 million and pre-tax profit grew by 42% to slightly over £50 million.

particularly Taiwan where we established a regional office in 2000.

Product development

We continue to invest heavily in research and development. Highlights in the year included the successful launch of our Jazelle technology, the development of our next-generation ARMv6 architecture, and the launch of our SecurCore™ range of cores, aimed at smart card and other markets in which security is important. Progress on our next-generation core, based on the ARMv6 architecture, is on track and we expect to release it later in the year.

Headcount

In view of the difficult environment, we decided early on in the year that it would be prudent to moderate headcount growth plans until the economy improved. Overall, headcount grew by 103 employees, from 619 at the start of 2001 to 722 at the end of 2001, compared with 2000 when we took on more than 170 employees. During the second quarter of 2001, we opened an office in Detroit to improve links with the US automotive industry.

We made one small business acquisition during the year: we acquired certain key technologies and assets, as well as the ten-person embedded debug design team, from Noral Micrologics Limited, based in Blackburn, UK.

Legal action

We were pleased to resolve our patent dispute with picoTurbo, Inc., in December. Under the terms of the settlement, picoTurbo assigned its intellectual property assets to ARM, acknowledged the validity and enforceability of our patents and agreed to cease all sales and marketing activities forthwith. Both companies agreed to work with picoTurbo's customers to effect a safe and smooth migration to the ARM roadmap for future designs. The continued protection of our intellectual property is very important to us. We now have more than 180 patent families, which cover the scope of our activities and comprise around 650 patents which have been filed or granted in multiple jurisdictions.

Board changes

We continued the logical evolution of our organisation to be able better to manage our growth. John Scarisbrick, previously a senior vice president of Texas Instruments, Inc., was appointed an independent non-executive director in August. In October, Warren East, previously Chief Operating Officer, was appointed Chief Executive Officer, enabling Robin Saxby to relinquish his combined role of Chairman and Chief Executive Officer, and to become Executive Chairman. At the same time, the board was strengthened with the appointment of two more executive directors: Tudor Brown joined as Chief Operating Officer, and Mike Muller as Chief Technology Officer. Both Tudor and Mike are founders of the Company and have enormous experience of the ARM world. Jamie Urquhart, Chief Strategy Officer, resigned from the board at the same time, enabling it to remain at a manageable size, but will continue with the Company as part of the senior executive team.

Finally, Jonathan Brooks, Chief Financial Officer for the past seven years, announced his intention to step down during the first quarter of 2002 and Tim Score, Finance Director of Rebus Group Limited, has been appointed to take over from him on 1 March 2002. While the evolution of the board has been considerable, we are confident we have the right people in place to take the Company forward.

Current trading and prospects

2002 has started well with several more licence agreements signed. Demand for our products and services continues to be good and we anticipate a further year of progress. In the current economic climate, some of our customers continue to experience weak trading conditions but this has not impacted on our licensing and development systems business to date. Our medium-term visibility could, however, be affected by a sustained downturn. The strength of our licensing business is built on the provision of leading-edge technology and we continue to increase our research and development activities to broaden the reach and application of our architecture.

Sir Robin Saxby
Executive Chairman

Warren East.

Warren East
Chief Executive Officer

ARM's success as one of the world's leading intellectual property (IP) companies lies in its constant drive to innovate.

We know, however, that success rests on more than ownership of the most innovative technology. From the outset, we realised that our success would also depend on building long-term Partnerships with the world's leading technology companies; their capabilities would set us free from manufacturing while, at the same time, enabling us to get our people's bright ideas to market.

On that basis, over the 11 years since the Company was founded, we have developed our business from the licensing of market-leading technology, through to providing end-equipment and device companies with more complete solutions, and have developed our Partnership agreements to cover a wider range of companies.

Innovative technology

In 2001, we took the concept of providing more complete solutions a step farther with the introduction of our family of PrimeXsys™ platforms, in which we have integrated our proven IP. These are larger building blocks that are a great place to start when designing next-generation chips. We still do not, however, provide "finished" end devices or, indeed, all the IP that would go into an end device. We leave that to our semiconductor and systems Partners, but the innovative tools and methodologies which we include in the platform enable our Partners to differentiate their end-products by adding their own IP. This reduces costs and gets their products to market more quickly.

During the past year, we also introduced our Jazelle technology to accelerate Java applications. Java is a portable, secure and platform-independent software environment that has revolutionised application development and deployment across networks. In the past, however, Java technology demanded memory and power resources that were too large to work effectively on wireless devices. By overcoming this problem, ARM Jazelle technology enables quick and efficient delivery of data information services to next-generation 2.5/3G wireless devices wherever you are located.

Innovators

ARM's success as one of the world's leading intellectual property (IP) companies lies in its constant drive to innovate.

ARM Jazelle technology is a natural extension of our culture of designing for power-efficient systems which are also economical systems. The need for conserving power is obvious in wireless devices, but it is becoming significantly more important across all applications. Power is increasingly expensive in terms of end-equipment, size, weight and cost, and we are conscious that our efforts to limit its consumption also benefit the environment.

In October 2001, we presented our next-generation ARMv6 architecture. This architecture increases overall system performance by as much as 30%, improves the ability of ARM processors to interact with digital signal processors (DSPs) and boosts performance in audio and video devices by as much as eight times. In addition, as part of our focus on providing what we call re-usable IP, it extends the capability of our architecture without putting our Partners' earlier investments in software at risk.

Innovative Partnerships

Over the years, we have developed a wide range of Partnerships and have recently extended these to give smaller, niche companies access to our technologies.

As well as working closely with semiconductor and systems companies which use our innovative ideas to meet recognised needs in digital electronic products, we extend our architecture's capabilities by supporting our development tools Partners. These, in turn, create a virtuous circle by selling their tools to the ARM design community. Our design Partners develop ARM core-based solutions for specific applications – and those who are members of our ARM technology access programme, ATAP™, are given direct access to our technologies to enable them to create complex designs for third parties.

The result is that ARM Powered® products are everywhere: from handheld video games to digital cameras and from in-car navigation and safety devices to next-generation 2.5/3G mobile phones.

This convergence of technologies, combined with the demand for more functions, is making systems far more complex and, as a result, more difficult to develop at a sensible cost and in the limited time available to get a new product to market.

Since very few manufacturers can now afford the prohibitive cost of developing and maintaining proprietary microprocessor cores, and OEMs want to build devices that incorporate IP from a variety of specialist providers, we satisfy their demands by designing standard "digital engines" that can be used as the building blocks for chips.

Innovative people

We long ago realised that it is smart ideas which create the value in our business and which will drive its growth. Of our 700+ people, around 500 are engineers who, we believe, are some of the finest in the world.

We take great care to find and retain them. Our efforts include sponsoring promising students at a number of universities and, in September 2000, we began to sponsor a new four-year MEng degree at Loughborough University. We also make our technology available to universities by creating special types of licence that make it affordable for them. It is our belief that in partnering with universities we are helping to train the next generation of innovative engineers, some of whom will come to work at ARM.

We tell you more about ARM's innovative technology, innovative Partnerships and innovative people on the following six pages.

ARM's engineers constantly seek ways to advance technology by finding innovative means of making electronic devices work faster, use less power, deliver more information and cost less.

Our new ARMv6 architecture is a significant step towards making electronic devices more efficient and economical. Developed with our architectural licensees, Intel Corporation and Motorola, and through our year-long collaboration with Texas Instruments, it is designed specifically to meet the needs of 3G wireless and other next-generation consumer products.

The ARMv6 architecture includes many technical innovations designed to make complex operating systems run faster and more efficiently. It is also designed to work seamlessly with our Partners' IP cores to create rich and complex system-on-chip solutions. In addition, the new architecture will enable developers of audio and video applications to make significant savings in power.

Handheld devices using the new architecture may not be in general use for some years, but the ARMv6 architecture will help to create more functions, including interactive gaming, electronic commerce and streaming video. The improved quality and extended battery life it gives will ensure that multi-function wireless devices quickly become commonplace.

Our focus on low power was the catalyst for the development of our Jazelle technology. Many of the more complex wireless functions are driven by Java technology – a portable, secure, platform-independent language that has revolutionised application development. Until recently, Java technology was generally considered too demanding for memory and power requirements to be effective on wireless devices.

ARM Jazelle technology changed this by providing developers with the means to run Java technology at up to eight times the performance of software-based solutions and at twice the performance of typical coprocessor solutions. By removing the need for an external accelerator, Jazelle technology reduces hardware costs and power consumption, and facilitates integration with industry-proven operating systems and applications.

Our extended SecurCore technology integrates Jazelle technology for the Sun® Java Card™, the leading operating system for smart cards and, in particular, for SIM cards in GSM and 3G mobile phones. The addition of our SC200™ family of cores to what is already the most widely-licensed line of microprocessors for smart card applications, underscores our commitment to delivering innovative solutions for the security market.

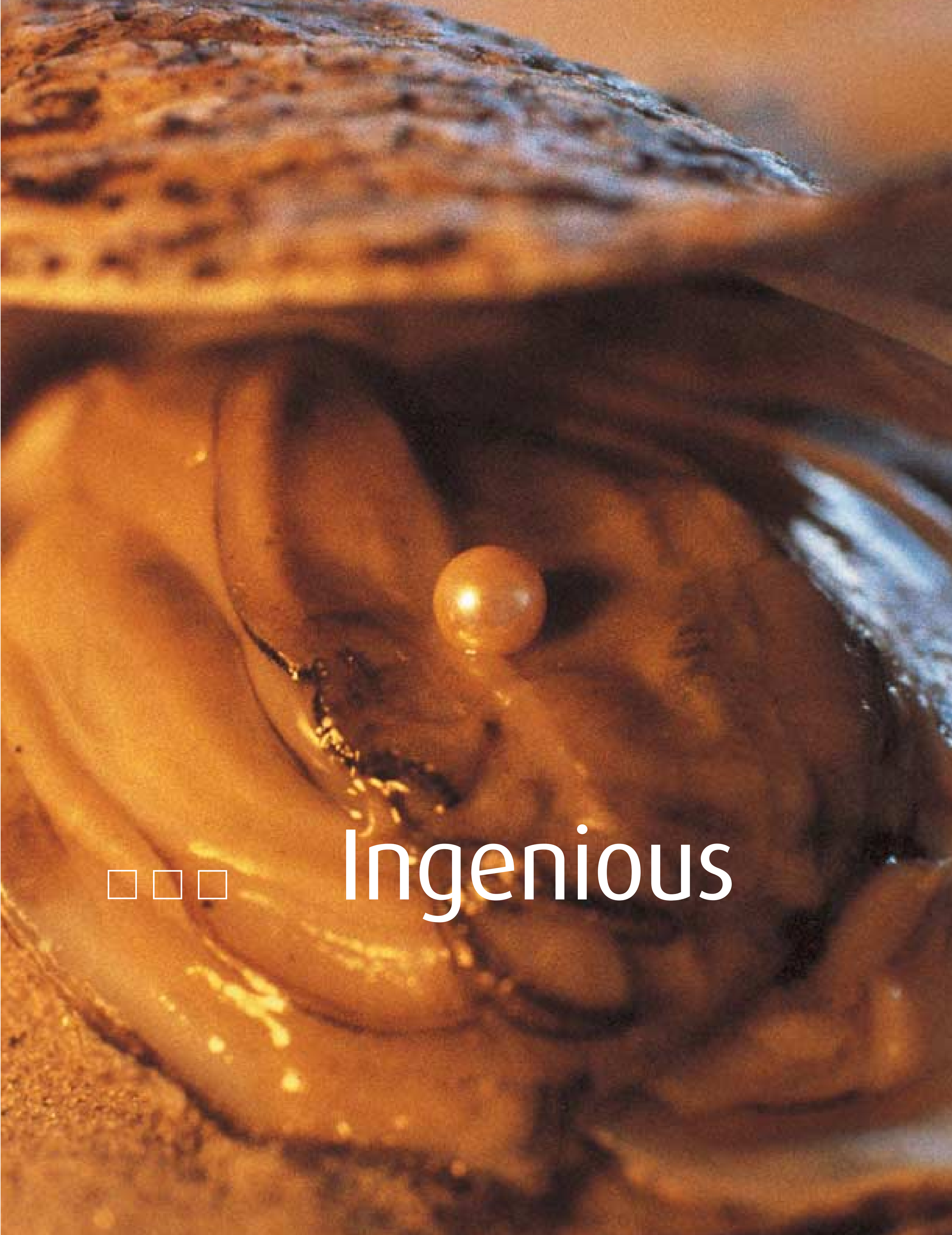
The SC200 family of cores gives developers of smart card software the highest performance combined with the best energy efficiency for any system based on Java Card technology. We took this a step farther with our SC210™ core; this additionally integrates a cryptographic accelerator to provide a level of performance unmatched by existing solutions.

Our new PrimeXsys Wireless Platform also includes our Jazelle technology. Based around the ARM926EJ-S microprocessor core, the PrimeXsys Wireless Platform is the first in our family of PrimeXsys platforms. It has been designed for 3G mobile phones and personal digital assistants (PDAs) and reduces development risk and time-to-market by including the innovative tools and methodologies our Partners need to differentiate their end products.

In developing the PrimeXsys Wireless Platform, we worked closely with our silicon and OEM Partners to ensure that they would gain the maximum benefit from this standard application platform, and that it would support all the major operating systems. We are now working with additional hardware and software developers to ensure that their IP will also be available for ARM PrimeXsys platforms.

Ingenious technology

ARM's engineers constantly seek ways to advance technology by finding innovative means of making electronic devices work faster, use less power, deliver more information and cost less.


Ingenious


Integrated □□□

ARM's success is, to a large extent, the result of its unique Partnership culture. Our relationships with the world's leading technology companies have made our architecture the paradigm for high-performance, low-cost microprocessors.

We license our ideas and innovations to our semiconductor and systems Partners. We also provide the support they need to develop complete systems and to ensure that our combined efforts produce or deliver digital electronic products that satisfy market needs.

We extend this through our Electronic Design Automation (EDA) Partnership programme. This cuts costs and time-to-market by enabling designers to verify circuits before beginning production. The programme combines the core competencies of leading EDA vendors with our expertise in resuable IP, to develop the optimum core integration methodology for each new generation of semiconductor manufacturing technology.

By supporting the ARM architecture, our development tools Partners are able to sell the most comprehensive tools for any architecture to our growing design community. In doing so, they extend our architecture's capabilities while developing their own businesses.

Our design Partners develop ARM core-based solutions for customers' specific needs. We have extended our relationship with these companies through our technology access programme, ATAP. This provides a framework for selecting companies to become ARM Approved Design Centres. It increases the value of ARM core-based solutions by adding skilled resource and application expertise in key geographies to minimise time-to-market for complex ARM core-based system-on-chip designs.

Our applications software Partners run their systems on our architecture. We use our software expertise to develop proven solutions for our silicon and systems Partners to use on their ARM Powered processors. Our optimised software components enable them to increase power efficiency and decrease cost.

We have extended our Partnership model to give niche companies access to our technology. These companies are fabless (they do not have in-house foundry facilities), and prefer to fabricate through specialist silicon foundries rather than through competing silicon vendors. By setting up Partnerships with foundries we enable them to achieve this while, at the same time, protecting our IP. The niche companies add their own IP to a "footprint" of our core: the actual technology is then inserted by one of the licensed foundries.

This innovative style of Partnership enables niche companies to design around our cores and to get their ideas to new high-growth markets quickly and cost effectively. It is an example of the ways in which we evolve our Partnership model to meet changing market needs.

Integrated partnerships

ARM's success is, to a large extent, the result of its unique Partnership culture. Our relationships with the world's leading technology companies have made our architecture the paradigm for high-performance, low-cost microprocessors.

ARM values its people. It is their skills and knowledge that have enabled us to build a culture of continuous innovation.

Our company has grown from 12 people in 1990 to more than 700 in 2001 and we now work from 18 sites in nine countries. During this rapid expansion, it would have been easy to lose sight of what makes us an excellent company to work for, but we have focused on conserving our culture and on perpetuating what was good about being a small company while reaping the benefits of growth.

Our innovative people understand the commercial world: they know that having bright ideas is not enough. They realise that the technologies they design can impact on millions of people's lives, and that it is important to respect the cultures, laws and regulations of the countries in which we operate.

We invest in recruiting, training and retaining the right people to enable us to build the next generation of business leaders from within the Company.

We naturally look to recruit people who are academically able, but it is equally important to us that they have the ability to develop relationships inside and outside the Company, particularly with our Partners, and that they are comfortable with our culture.

The vast majority of our people have stayed with ARM because the environment is stimulating and they are encouraged to believe they can make a difference.

When people join, they go through our induction system to introduce them to our values and culture, are assigned "buddies" (who have recently been through the joining process themselves) and, on a more formal level, are coached and mentored by a senior engineer.

Our people work in teams, the leaders of which are more concerned about employee development than about command and control. We ensure that employee and Company meet one another's expectations through a feedback and development process.

We nurture the skills and creativity of the next generation through our close links with leading universities. Our engineers mentor research projects at universities, many of which run ARM experiments in their undergraduate labs. In addition, the ARM university programme enables universities and institutions to buy many of our development products at reduced cost. We have also generated two specific licences that permit universities to work with our IP and which help to create interest in, visibility of, and excitement about, our technology.

We target interested students and sponsor those who we consider to be promising (about 80 at any one time) by offering them work placements in vacations and bursaries for their final years. By the time they join our team as graduates, they are already immersed in our culture and are committed ARM people.

We extended our university programme by sponsoring a four-year MEng degree at Loughborough University. We work with the university to select first-year students, support them throughout their degree course and give them summer jobs.

While we don't expect to achieve ready-made intellectual property from these programmes, we firmly believe in the long-term value of investing in education – and in helping to train the next generation of ARM innovators.

Inspiring people

ARM values its people. It is their skills and knowledge that have enabled us to build a culture of continuous innovation.


Inspiring

Directors and advisers

Sir Robin Saxby age 55
Executive Chairman
Robin Saxby served as Chairman, President and Chief Executive Officer between joining the Company full time in February 1991 and October 2001, when he was appointed Executive Chairman. Before joining ARM, he worked for European Silicon Structures SA (ES2), where he was Vice-President of Northern Europe, Managing Director ES2 Limited and President of its US affiliate US2. Between 1984 and 1986, he was Chief Executive Officer of Henderson Security Systems Limited and, before that, spent 11 years with Motorola Semiconductors. He has also served as Chairman of the Open Microprocessor Initiative Advisory Group, a European Union panel set up to advise on collaborative R&D activity in Europe. In 2000, Robin was awarded an honorary Doctorate DEng from Liverpool University. He was also appointed a visiting professor to his old department of electronics at the university. In July 2001, he was awarded an honorary Doctorate DTech from Loughborough University. He was knighted in the 2002 New Year's Honours List. In April 1999, he was appointed as a non-executive director of Glotel plc.

Warren East age 40
Chief Executive Officer
Warren East joined ARM in 1994. He set up ARM's consulting business and served as Vice President Business Operations from February 1998. In October 2000 he was appointed to the board as Chief Operating Officer and in October 2001 was appointed Chief Executive Officer. Before joining ARM he was with Texas Instruments for 11 years and latterly managed TI's FPGA marketing in Europe.

Jonathan Brooks age 46
Chief Financial Officer
Jonathan Brooks joined ARM as Chief Financial Officer in February 1995 and was appointed to the Board in March 1998. He will retire in March 2002. He previously worked for Accor Group SA where he held senior financial positions, including Finance Director of LV Group Limited between 1989 and 1991, Group Management Accountant based in Paris, between 1991 and 1993, and Finance Director of WL Japan KK between 1993 and 1995. Between 1988 and 1989 he was Group Financial Controller of Frederick's Place Holdings plc. He had previously spent seven years with ICI plc in a variety of financial roles and two years with Grant Thornton Management Consultants. He was appointed to the board of Aortech International plc as a non-executive director in February 2001.

Tudor Brown age 43
Chief Operating Officer
Tudor Brown has been with ARM since its inception. He was previously with Acorn Computers where he was Principal Engineer, working exclusively on the ARM R&D programme from 1984. He served as Engineering Director and Chief Technical Officer from 1993 until October 2000 when he was appointed Executive Vice President Global Development. In October 2001 he was appointed to the board as Chief Operating Officer.

Peter Magowan age 34
Executive Vice President Business Development
Peter Magowan joined ARM in 1992 and has subsequently held a variety of sales, marketing and business development roles. From 1996 to October 1999 he served as Vice President European Sales and was appointed Vice President Worldwide Sales in October 1999. In October 2000 he was appointed to the board as Executive Vice President Sales and Marketing and, in July 2001, he was appointed Executive Vice President Business Development. Before joining ARM he worked for SGS Thomson Microelectronics. He was appointed to the board of Amphion Semiconductor Ltd as a non-executive director in September 2000.

Michael Muller age 43
Chief Technology Officer
Michael Muller has been with ARM since its inception. He was previously with Acorn Computers, where he was responsible for hardware strategy and the development of portable products. He has been involved with ARM technology developments from their beginning in 1982 as a member of Acorn's Advanced R&D team. Before joining Acorn he worked for Orbis Computers where he specialised in networked distributed computing and high-speed local area networks. At ARM he served as Vice President Marketing from 1992 to 1996 and as Executive Vice President Business Development from 1996. In October 2000, he was appointed Chief Technology Officer and in October 2001 was appointed to the board.

Peter Cawdron, age 58
Independent Non-Executive Director
Peter Cawdron was appointed to the board of the Company in March 1998. From 1983 to 1998 he worked for Grand Metropolitan PLC where he served as Group Strategy Development Director from 1987 and Director of Planning before that. From 1977 to 1983, he was Chief Financial Officer and Director of D'Arcy-MacManus & Masius Worldwide, Inc. Before that, he spent seven years at S.G. Warburg & Co., Ltd as a member of the Corporate Finance Department and as Senior General Manager from 1976. From 1961 to 1970 he worked at Peat, Marwick, Mitchell & Co, where he qualified as a Chartered Accountant in 1966. He serves as Chairman of Capital Radio plc and as a non-executive director of Compass Group plc, The Capita Group plc, Christian Salvesen plc, COIF Nominees Ltd, Express Dairies plc, Granada Compass plc, Johnston Press plc, Lupus Capital plc, Private Investor Capital Ltd and Prospect Digital Media Ltd.

The board, from left: Lawrence Tesler, John Scarisbrick, Jonathan Brooks, Warren East, Robin Saxby, Peter Magowan, Doug Dunn, Peter Cawdron, Michael Muller, Tudor Brown

Doug Dunn age 57
Independent Non-Executive Director
Doug Dunn was appointed to the board in December 1998. He is currently President and Chief Executive Officer of ASM Lithography Holding N.V. From 1993 to 1998 he worked for Royal Philips Electronics N.V. initially as Chairman and Chief Executive Officer of the Semiconductor division and a member of the Philips Group Management Committee. In 1996 he was appointed Chairman and Chief Executive Officer of the Consumer Electronics division and a member of the Philips board. From 1980 to 1993 he was Managing Director of the Plessey and GEC Semiconductor divisions. Before this he worked for Motorola in several engineering and management functions. He was awarded an OBE in 1992 for services to the electronics industry. He is also a non-executive director of Sendo Holdings plc.

Lawrence Tesler age 56
Independent Non-Executive Director
Lawrence Tesler is Vice President of Engineering for Amazon.com Holdings, Inc., the online retailer. From 1980 to 1997, he worked for Apple Computer, Inc., where he served as Vice President and Chief Scientist. Between 1963 and 1980, he was on the staff of the Xerox Palo Alto Research Center, President of a software consulting firm, and a research associate at Stanford University. He was a member of the ARM board from its foundation until August 1997, and rejoined the board as a non-executive director in March 1998.

John Scarisbrick age 49
Independent Non-Executive Director
John Scarisbrick was appointed to the ARM board in August 2001. Before that he served 25 years at Texas Instruments in France, Texas and England, where he was most recently responsible for its $5 billion ASP business, which included DSP, wireless, ASIC, SPARC, and broadband businesses worldwide. He was previously President of Texas Instruments Europe and had led the team that created TI's DSP business in Houston, Texas. Before joining TI he worked in design roles at Rank Radio International and Marconi Space and Defence Systems. He is a venture partner at Vortex Partners LLP in Dallas, Texas, and serves on the Technical Advisory Board of ViVentures, a Paris-based venture investor; he is also a director of SoniM, the leading developer of 2.5/3G voice instant messaging applications.

Secretary and registered office
David N Mackay
110 Fulborn Road
Cambridge CB1 9NJ
UK

Registered number
2548782

Stockbrokers
Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA
UK

Morgan Stanley & Co. International Limited
25 Cabot Square
Canary Wharf
London E14 4QA
UK

Legal advisers
UK law
Linklaters & Alliance
One Silk Street
London EC2Y 8HQ
UK
US law
Davis Polk & Wardwell
99 Gresham Street
London EC2V 7NG
UK

Auditors
PricewaterhouseCoopers
Abacus House
Castle Park
Cambridge CB3 0AN
UK

Registrars
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
UK

Depositary
The Bank of New York
101 Barclays Street
New York
New York 10286
USA

Financial review

In order to comply with applicable UK and US securities regulations, ARM Holdings plc prepares financial statements under both UK and US generally accepted accounting principles (GAAP) both of which are included in this report. The financial statements prepared under UK GAAP can be found on pages 28 to 50 and under US GAAP on pages 56 to 71.

A reconciliation of the differences between the two sets of GAAP can be found in note 29 of the UK GAAP financial statements.

Turnover
Turnover for the 12 months ended 31 December 2001 amounted to £146.3 million, an increase of 45% from total revenues of £100.7 million in the 12 months ended 31 December 2000.

Licensing revenues grew by 69% to £76.8 million in 2001 compared with £45.4 million for 2000. The growth in licensing fees was as a result of a number of factors: first, the number of licensees of the Company's technology grew from 50, at the end of 2000, to 77 at the end of 2001; second, approximately half of the Company's existing licensees chose to purchase some 46 further products from us; third, the licensing of "non-core-based" technology, comprising peripherals, models and application software, grew to £11.9 million in 2001, representing 15% of total licence revenues, compared with £7.8 million in 2000.

Royalty revenues grew by 9% to £27.9 million in 2001 compared with £25.6 million in 2000. The number of licensees shipping silicon chips based on the ARM architecture increased to 33, ten higher than in the corresponding period in the previous year, and the range of end markets in which our technology is used broadened further to include smart cards, printers and digital cameras. Unit shipments grew by 14% from 367 million units in 2000 to 420 million units in 2001.

The strong level of demand for development systems continued, with year-on-year sales up 71% to £23.3 million, compared with £13.6 million in 2000. The level of demand for our development systems products continues to give us confidence that there is an increasing level of ARM technology-based design activity around the world; revenues are approximately 40% in East Asia, 35% in the United States and 25% in Europe.

Service revenues, which include consulting services and revenues from support, maintenance and training, grew to £18.3 million, representing 13% of total revenues compared with £16.2 million or 16% of revenues in 2000. Consulting revenues declined by 10% to £7.4 million, compared with £8.2 million in 2000, while revenues from support, maintenance and training grew by 37% to £10.9 million from £8.0 million. The reduction in consulting revenues was a direct result of the reallocation of resource from consulting projects to new licensing projects, including the development of the new PrimeXsys Wireless Platform which was licensed to two Partners during the year.

Operating expenses
Research and development expenses increased to £38.9 million in 2001 compared with £27.5 million in 2000. The continuing increase in research and development expenditure demonstrates our commitment to investing in developing next-generation products. Sales and marketing costs grew from £18.0 million in 2000 to £21.5 million in 2001. General and administration costs grew from £12.3 million in 2000 to £22.8 million in 2001, including £5.4 million of cost relating to legal fees relating to the now-resolved litigation against picoTurbo, Inc.

Earnings and taxation
Operating margins, when measured under UK GAAP, increased slightly to 31.3%, or £45.8 million in 2001, compared with 30.8% or £31.1 million in 2000. We made a small net gain of £0.3 million on our minority investments in 2001, resulting from profits on the disposal of our investments in Parthus Technologies plc and Sirius Communications BV during the year. Interest received increased from £3.9 million for 2000 to £4.5 million in 2001, reflecting the Company's increasing cash balance that rose from £75.3 million at 31 December 2000 to £104.5 million at 31 December 2001.

Under UK GAAP, profit before taxation was £50.6 million, or 34.6% of revenues compared with £35.5 million, or 35.2% of revenues, in the 12 months ended 31 December 2000.

The group's taxation rate measured under UK GAAP rose from 14% in 2000 to 31% in 2001. The lower taxation rate in 2000 was primarily as a result of the tax savings resulting from contributions to the Company's Qualifying Employee Share Ownership Trust (QUEST), set up in 1999 to acquire new shares in the Company for the benefit of employees and directors of the group. Contributions to the QUEST saved £5.3 million of tax in 2000.

Fully diluted earnings for 2001 under UK GAAP were 3.4 pence per share compared with 2.9 pence per share for the previous 12 months. Supplemental earnings per share, which exclude the beneficial effect of the QUEST as well as the effect of goodwill, increased from 2.5 pence per share in 2000 to 3.6 pence in 2001.

Cash flow and capital expenditure

The group generated £57.0 million of net cash from operating activities, compared with £41.9 million in 2000. Capital expenditure and financial investment increased to £25.8 million compared with £18.7 million in 2000. Of this, £17.3 million represented the purchase of tangible fixed assets, with the majority, £12.8 million, being spent on computer equipment and design tools, and £4.5 million on leasehold improvements, fixtures and fittings. £8.5 million was spent on the purchase of intangible fixed assets in 2001 compared with £2.8 million in 2000.

Tax paid in the year amounted to £9.6 million compared with £2.9 million in 2000. Interest received rose to £4.6 million compared with £3.8 million in 2000.

The group's overall cash and short-term investments increased by £29.2 million to £104.5 million at the end of 2001 compared with £75.3 million at the end of 2000.

Jonathan Brooks
Chief Financial Officer

Selected financial data/UK format

	2001	2000	1999	1998	1997
	£000	£000	£000	£000	£000
Turnover	**146,274**	100,730	62,120	42,268	26,580
Cost of sales	**(17,289)**	(11,647)	(9,803)	(8,316)	(6,685)
Gross profit	**128,985**	89,083	52,317	33,952	19,895
Total operating expenses	**(83,203)**	(57,927)	(35,794)	(25,638)	(15,343)
Group operating profit	**45,782**	31,156	16,523	8,314	4,552
Share of loss of associated undertaking	**–**	(85)	–	(71)	(31)
Total operating profit	**45,782**	31,071	16,523	8,243	4,521
Net gain on disposals of trade investments	**314**	–	–	–	–
Gain on part disposal of associated undertaking	**–**	512	–	–	–
Interest receivable, net	**4,470**	3,912	2,266	1,911	484
Profit on ordinary activities before taxation	**50,566**	35,495	18,789	10,154	5,005
Tax on profit on ordinary activities	**(15,606)**	(5,032)	(1,776)	(3,507)	(1,661)
Profit on ordinary activities after taxation	**34,960**	30,463	17,013	6,647	3,344
Equity minority interest	**(303)**	(192)	(64)	(8)	(15)
Profit attributable to shareholders	**34,657**	30,271	16,949	6,639	3,329
Dividends	**–**	–	–	(4,000)	–
Retained profit for the financial year	**34,657**	30,271	16,949	2,639	3,329
Capital expenditure	**17,349**	11,842	5,900	6,402	4,033
Cash and short-term investments	**104,467**	75,266	51,804	39,591	7,405
Shareholders' funds	**137,527**	101,298	67,683	49,324	12,195
Employees at end of year	**722**	619	443	354	274

Compliance with the Combined Code
The Company complies, and complied throughout 2001, with the Combined Code appended to the Listing Rules of the Financial Services Authority.

Composition and operation of the board
The composition of the board has been enhanced during the year with the appointment of one additional non-executive director in August, two further executive directors in October and a separation of the roles of Chairman and Chief Executive Officer which was formalised at the end of the third quarter. The board now comprises an Executive Chairman, Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Technology Officer and Executive Vice President of Business Development and four independent non-executive directors. In reorganising the board the objective has been to get a wider group of executive directors together capable of providing a broader range of perspectives to the board on commercial and technical issues. The four independent non-executive directors provide a blend of experience to enable them to bring strong independent judgement and considerable knowledge and experience to the board's deliberations. Peter Cawdron has extensive knowledge of UK public company issues. Doug Dunn has experience of running large companies in the semiconductor and electronics industry. Lawrence Tesler and John Scarisbrick both have a broad understanding of the Company's technology and the practices of major US-based technology companies. The board believes that the recent modifications to its structure will ensure that it is well prepared to manage the anticipated growth of the group.

The board has six regularly scheduled meetings a year with additional meetings on any pertinent issues organised, as necessary, during the year. The board is responsible for the development of business and commercial strategy, monitoring progress, the approval of major business matters, policies, operating and capital expenditure budgets, ensuring high standards of corporate governance are maintained, final approval of senior executive remuneration and succession planning for top management. The board is also responsible for sanctioning unusual commercial arrangements such as atypical licence agreements and investments. Before each meeting, the board is furnished with information in a form and quality appropriate for it to discharge its duties concerning the state of the business and its performance. The ultimate responsibility for reviewing and approving the annual report and accounts and the quarterly reports, and for ensuring that they present a balanced assessment of the group's position, lies with the board. The board delegates the day-to-day responsibility of managing the group to its Executive Committee and has a number of sub-committees, details of which are set out below.

Executive committee
The executive committee is responsible for the implementation of the strategy set by the board. Among other things, this committee is responsible for approval of standard licence agreements, ensuring the group's budget and forecasts are properly prepared, ensuring targets are met, and generally managing and developing the business within the overall budget. Variations from the budget and changes in strategy require approval from the main board of the Company. The executive committee, which meets monthly, comprises the executive directors, the directors of ARM Limited, representatives of the group's overseas operations and other senior operational personnel as appropriate.

Audit committee
The audit committee has responsibility for, among other things, keeping under review the scope and results of the external audit, the review of the annual report and accounts and half-year interim report, the involvement of the auditors in those processes, considering compliance with legal requirements, accounting standards, the Listing Rules of the Financial Services Authority and the requirements of the Securities and Exchange Commission and for advising the board on the requirements to maintain an effective system of internal controls. The current audit committee comprises Peter Cawdron (Chairman), Doug Dunn and John Scarisbrick. John Scarisbrick joined the audit committee in November 2001 following his appointment to the main board in 2001 and Lawrence Tesler, who had been a member of the audit committee since 1998, resigned from the audit committee in December. The committee keeps under review the independence and objectivity of the group's auditors, value for money of the audit and the nature, extent and cost-effectiveness of the non-audit services provided by the auditors. The committee meets three times a year, once to review the half-year interim results, once before the year end to discuss the annual accounts and the approach to the audit, and once before the release of the preliminary announcement of the annual results to review the previous year's results and audit findings. The external auditors and Chief Financial Officer attend all meetings in order to ensure that all of the information required by the audit committee is available for it to operate effectively. All directors may attend and, at least once a year, the representatives of the Company's auditors meet with the audit committee without any executive directors being present.

Remuneration committee
The remuneration committee has responsibility for making recommendations to the board, within agreed terms of reference, on the Company's policy on executive remuneration and the individual remuneration packages for the executive directors including pension rights and any compensation payments. It is chaired by Doug Dunn. Peter Cawdron, John Scarisbrick and Lawrence Tesler are also members of this committee which meets at least twice a year. The committee has access to professional advice from outside advisers in the furtherance of its duties and makes use of this. Coming from diverse backgrounds, the four independent non-executive directors are able to offer a balanced view with respect to remuneration issues for the group. The Executive Chairman, Chief Executive Officer and Executive Vice President of Human Resources will normally attend these meetings. No director is involved in deciding his or her own remuneration. The report of the board on remuneration is set out on pages 23 to 26.

Nominations committee

The nominations committee has responsibility for proposing to the board any new appointments of both executive and non-executive directors. It is chaired by the Executive Chairman, and is attended by the four independent non-executive directors, Peter Cawdron, Doug Dunn, John Scarisbrick and Lawrence Tesler. The committee meets as required.

Internal control

The board of directors has overall responsibility for ensuring that the group maintains an adequate system of risk management and internal control and for reviewing its effectiveness. Such systems are designed to manage rather than eliminate the risks inherent in a fast-moving, high-technology business and can, therefore, only provide reasonable and not absolute assurance against material misstatement or loss.

The central process for managing risk is a series of interconnected meetings that span the group from a detailed weekly operational meeting chaired by the Chief Operating Officer to the main board meetings of the Company. Each week a business review meeting is held whose purpose is to monitor and control all main business activities, sales forecasts and other matters requiring approval that have arisen within the week. Each month, the outputs of this weekly business review meeting are reviewed by the Executive Committee which, in turn, raises relevant issues with the main board of the Company. These processes for identifying, evaluating and managing the significant business, operational, financial, compliance and other risks facing the group have been in place for the year under review and up to the date of approval of the annual report and financial statements. They accord with the guidance on internal control issued in September 1999 by the Internal Control Working Party of the Institute of Chartered Accountants in England and Wales.

Given the group's relatively small size of a little over 700 employees, and the high degree of centralisation in the way the business is run, the board does not consider that it would be practicable to have its own financial internal audit function for the present. Instead, it has chosen to date to contract out such activities on a project-by-project basis to independent firms of accountants. It does, however, have an internal audit function that carries out activities designed to improve processes within the group. These include reviewing progress on engineering projects to ensure these are carried out to the high standards necessary for the group to comply with its ISO9001 status, establishing improved information flows, and developing better project approval and project management systems appropriate to the increasing complexity of the group.

Corporate social and ethical policies

While the Company is accountable to its shareholders, it also endeavours to take into account the interests of all its stakeholders, including its employees, customers and suppliers, and the local communities and environments in which it operates. The Company joined the Institute of Business Ethics in 2000 with a view to adopting its Good Corporation Charter. Following a process of independent verification during the year, the Company received confirmation of its admittance to the Good Corporation Network in August 2001. This qualification assures that the Company has been independently verified against a 21-point charter covering the fair treatment and protection of its employees, customers, suppliers, shareholders, the community and the environment. As a company whose primary business is the licensing of intellectual property, employees are highly valued and their rights and dignity are respected. The Company strives for equal opportunities for all its employees and does not tolerate any harassment of or discrimination against its staff. The Company also endeavours to be honest and fair in its relationships with its customers and suppliers and to be a good corporate citizen respecting the laws of the countries in which it operates.

Environmental policies

The group's premises are composed entirely of offices since it has no manufacturing capability. "Raw materials" principally comprise staff and computer-aided design tools, while "production processes" are related to the generation of intellectual property that involves neither hazardous substances nor complex waste emissions. With the exception of Development Systems products, the majority of "products" sold by the group comprise microprocessor core designs that are delivered electronically to customers.

However, the group does recognise the increasing importance of environmental issues and these are discussed at board level where the Chief Financial Officer takes responsibility for these issues. A number of initiatives in this area have been started during 2001. Most importantly, an environmental policy has been formulated which is published on the Company's website. From this, an environmental action plan has been developed following a review of all the main aspects of the business, taking account of their impact on the environment. This action plan is being implemented through various initiatives. These include improving our understanding of resource consumption and waste creation so that targets can be set for improvement, ensuring existing controls continue to operate satisfactorily, and working with our suppliers to enhance environmental management along the supply chain.

Baseline data has been compiled during 2001 on energy use, including estimates for both international business travel and transport to, and from, work. The group does not encourage the provision of company cars, which number fewer than 20 in total. Additionally, the provision of cycle sheds, showers and changing facilities at the group's UK offices provides an incentive to greener commuting and the extensive provision of conference telephone and video conferencing equipment provides an alternative to international travel, where appropriate. A document output study has been established to examine paper consumption within the group and to consider how an extension of the group's electronic document management systems might reduce the need for paper documents. The group has also introduced a rolling programme of environmental improvements to its offices: indeed, in its newer offices, it has encouraged the use of less environmentally-damaging refrigerants in the air conditioning systems, and the avoidance of ozone-depleting fire suppressants in the computer centre.

Relationships with shareholders

The board makes considerable efforts to establish relationships with institutional shareholders. The Company has a regular dialogue with institutional shareholders throughout the year other than during close periods. The board also encourages communication with private investors throughout the year. At present, around 20 analysts write research reports on the Company. The Company publishes telephone numbers on its website enabling shareholders to listen to earnings presentations and audio conference calls with analysts. All shareholders may register to receive the Company's press releases via the internet, and internet links to recordings of earnings presentations and audio conference calls are available at the appropriate time on the Company's website. The board actively encourages participation at the Annual General Meeting, scheduled for 18 April 2002, which is the principal forum for dialogue with private shareholders. A presentation will be made by the Executive Chairman regarding the Company's technology and its objectives and an open question-and-answer session will follow to enable shareholders to ask questions about the business in general.

Going concern

After making enquiries, the directors have a reasonable expectation that the group and Company have adequate resources to continue in operational existence for the foreseeable future. For this reason, they have adopted the going concern basis in preparing the financial statements.

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and the group, and of the profit or loss of the group for the period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and to apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the group and for ensuring that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the board

David MacKay Company Secretary

Directors' report/UK format

The directors present their annual report and audited financial statements for the year ended 31 December 2001.

Principal activities and review of business

The principal activities of the Company and its subsidiaries are the licensing, marketing, research and development of RISC-based microprocessors and systems. The nature of the global semiconductor industry is such that most of its business is conducted overseas and, to better serve its customers, the group has sales offices around the world. These include six offices in the US and offices in Tokyo, Japan; Seoul, South Korea; Taipei, Taiwan; Tel Aviv, Israel; Paris, France; and Munich, Germany. Design offices are based in Cambridge, UK; Maidenhead, UK; Sheffield, UK; Blackburn, UK; Sophia Antipolis, France; and Austin, Texas in the United States. A review of business is set out in the Chairman's and Chief Executive Officer's review on pages 4 and 5, the review of operations on pages 6 to 13, and the financial review on pages 16 and 17.

Future developments

The Company's stated objective is to establish a new global RISC architecture standard for the embedded microprocessor market. The directors believe that to achieve this goal it is important to expand the number and range of potential customers for its technology. To this end, the group intends to sign further licence agreements with new customers and to establish relationships with more third-party tools and software vendors to ensure that their products will operate on the ARM architecture. The group also plans to develop new technology to license to existing customers. To achieve its stated objective, the directors believe that the group will need to continue to increase its headcount over time in order to develop new technology and serve new customers. As a result of its position as an emerging standard in its industry, the group is presented with opportunities from time to time to acquire complementary technology or resources. During the year, the group acquired part of the assets and trade of Noral Micrologics Limited, a small software house based in Blackburn, UK, whose technology has been integrated within the group's development systems products. At the present time, the group has no immediate plans, commitments or understandings with respect to any further acquisitions.

Dividends

With the exception of the dividend paid at the time of its initial public offering in April 1998, the Company has never paid nor declared any dividends on its shares in line with its peer companies in the high-technology sector in the US. Although the policy will be kept under review, the directors do not anticipate paying dividends in the future. No interim dividend was declared during the year and the directors do not recommend the payment of any final dividend for the year.

Research and development

Research and development is of major importance and while the group does not undertake any pure research, it does collaborate closely with universities worldwide. Key areas of product development for 2002 include the development of additional versions of the ARM10 core, the first implementations of the group's ARMv6 architecture, microprocessor cores targeted at the smart card market, research into future microprocessor architectures for launch in three to four years' time and enhanced applications software and development tools offerings.

The group incurred research and development costs of £38.9 million in 2001, compared with £27.5 million in 2000, which have been charged to the profit and loss account.

Donations

The group made charitable donations of £71,027 (2000: £41,750) during the year.

Directors in the year

The following served as directors of the Company during the year ended 31 December 2001.

Sir Robin Saxby KBE (Executive Chairman)
Warren East (Chief Executive Officer)
Jonathan Brooks (Chief Financial Officer)
Tudor Brown (Chief Operating Officer) appointed 12 October 2001
Peter Magowan (Executive Vice President Business Development)
Michael Muller (Chief Technology Officer) appointed 12 October 2001
Jamie Urquhart (Chief Strategy Officer) resigned 12 October 2001
Peter Cawdron (independent non-executive)
Doug Dunn OBE (independent non-executive)
John Scarisbrick (independent non-executive) appointed 31 August 2001
Lawrence Tesler (independent non-executive)

During 2001 Doug Dunn was the senior independent non-executive director.

Election of directors

In accordance with the Company's articles of association, Robin Saxby and Doug Dunn will retire by rotation at the Company's Annual General Meeting and will seek re-election at that meeting. See pages 14 and 15 for their biographies. In accordance with provision A.6.2 of the Combined Code, which requires the election of directors by shareholders at the first opportunity after their appointment, Tudor Brown, Michael Muller and John Scarisbrick, who were appointed during the year, will submit themselves for election at the Company's Annual General Meeting. See pages 14 and 15 for their biographies. As independent non-executive directors, neither Doug Dunn nor John Scarisbrick has a service contract.

Directors' shareholdings in the Company

The interests of the directors in the Company's ordinary shares of 0.05 pence, all of which were beneficially held, are disclosed in the report of the board on remuneration on page 24.

Substantial shareholdings

At 11 February, no person has notified any interest in the ordinary shares of the Company which requires disclosure to the Company in accordance with Sections 198 to 208 of the Companies Act 1985 and represent material interests of 3% or more or any non-material interest of 10% or more of the issued share capital of the Company.

Disabled persons

The group has a strong demand for highly qualified staff and, as such, disability is not seen to be an inhibitor to employment or career development within the group. In the event of any staff becoming disabled while with the group, their needs and abilities would be assessed and the Company would, where possible, seek to offer alternative employment to them if they were no longer able to continue in their current role.

Employee involvement

As the Company is an intellectual property enterprise, it is vital that all levels of staff are consulted and involved in the decision-making processes of the group. To this end, internal conferences and meetings are held regularly which involve employees from all parts of the group in discussions on future strategy and developments. Furthermore, employee share ownership is encouraged and all staff are able to participate in one of the Company's schemes to encourage share ownership. The group has a very informal and delegated organisational structure. It does not presently operate any collective agreements with any trades unions.

Policy on payment of creditors

The group's policy is to pay suppliers within 21 days of the date of receipt of the invoice, unless terms have been specifically agreed in advance. This policy and any specific terms agreed with suppliers are made known to the appropriate staff and to suppliers on request. The average number of creditor days for the year ended 31 December 2001 was 11 days for the group (2000: 14 days), and nil days for the Company in both years.

Annual General Meeting

The Annual General Meeting will be held at Churchill College, Cambridge, on 18 April 2002 at 2pm. Buses will be available to take shareholders from the railway station in Cambridge to Churchill College. A presentation will be made at this meeting outlining recent developments in the business.

The Company will convey the results of proxy votes cast at the Annual General Meeting. Shareholders are invited to submit written questions in advance of the meeting. Questions should be sent to the Secretary, ARM Holdings plc, 110 Fulbourn Road, Cambridge CB1 9NJ. The auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office and a resolution that they be re-appointed will be proposed at the Annual General Meeting.

By order of the board

David MacKay Company Secretary
11 February 2002

Remuneration policy

The principal function of the remuneration committee is to make recommendations to the board on the remuneration and other benefits of all executive directors, including pension contributions, bonus payments, share options and service contracts. The remuneration committee in its current form and in its deliberations on the remuneration policy for the Company's directors seeks to give full consideration to the Combined Code including the provisions set out in Schedule A to that code.

The Company operates a remuneration policy for executive directors designed to ensure that it attracts and retains the management skills necessary for it to remain a leader in its field. This policy seeks to provide rewards and incentives for the remuneration of executive directors that reflect the performance and align with the objectives of the group. The committee believes that a director's total remuneration should seek to recognise his or her worth in the external market. The policy on executive director remuneration and appointments is set out below.

Total level of remuneration

The remuneration committee aims to ensure that individuals are fairly rewarded for their contribution to the rapid growth and success of the group. There is a strong bonus element to executives' remuneration of up to 45% of basic pay. In the past two years, bonuses of 45% and 32% respectively have been paid to executive directors. Bonuses are principally tied to the achievement of the group's annual budget, with 35% bonus being awarded if all targets are met. There are three main targets, namely the achievement of the budgeted level of sales, profit growth and forward orders generated for future periods, representing bonus opportunities of 12.5%, 12.5% and 10% of base salary respectively. A further 10% bonus based on individual performance is possible at the discretion of the remuneration committee. The nature of the group's development has meant that there has been a good deal of focus on the attainment of short-term objectives with a high level of variable remuneration and the committee believes that this remains an appropriate method of remuneration.

There are no long-term incentive plans in place although, as a way of providing some longer-term incentive, a deferred bonus scheme was introduced for executive directors in 2001. This enables them to defer up to 100% of their bonus for a period of up to three years during which time the amount of bonus deferred is increased by 33% per annum.

The Company operates a number of share option plans and all employees can expect to receive a number of share options according to their grade, past performance and length of service in the group. Typically, share options are allocated to employees on an annual basis during the first quarter of the year. Options under the discretionary (Approved, Unapproved and ISO) schemes are always issued at market value, while options issued under the Save As You Earn and Employee Stock Purchase Plans are issued at a 15% discount to market value. In line with practice among the group's peers in the technology sector, there are currently no performance conditions attached to the issue or exercise of discretionary options except for those issued to executive directors. For executive directors, discretionary share options of up to two times base salary may be issued each year that will vest after seven years. If, however, the Company achieves EPS growth of 33.1% above the rate of inflation over a period of three years, then all the options will be exercisable after three years.

The group does not operate its own pension scheme but makes payments into a "money purchase scheme" operated by third-party pension providers. The rate of group contribution is 10% of the executive's salary (25% in the case of the Executive Chairman) subject to the Inland Revenue salary capping limits.

Service agreements

Executive directors have "rolling" service contracts that are terminable by either party on one year's notice. These agreements provide for each of the directors to provide services to the Company on a full-time basis. The agreements contain restrictive covenants for periods of three to six months following termination of employment relating to non-competition, non-solicitation of the group's customers, non-dealing with customers and non-solicitation of the group's suppliers and employees. In addition, each service agreement contains an express obligation of confidentiality in respect of the group's trade secrets and confidential information and provides for the group to own any intellectual property rights created by the directors in the course of their employment.

Non-executive directors

During 2001, each non-executive director received a total fee of £22,000 per annum. This fee was arrived at by reference to fees paid by other companies of similar size and complexity, and reflected the amount of time non-executive directors were expected to devote to the group's activities during the year. The remuneration of the non-executive directors is set by the board of the Company and their term of appointment is three years. Non-executive directors do not have service contracts.

Directors' shareholdings in the Company

The interests of the directors in the Company's ordinary shares of 0.05 pence, all of which were beneficially held, are set out below.

Director	**31 December 2001 Number**	31 December 2000 or on appointment Number
R Saxby	**26,132,860**	26,093,000
W East	**154,920**	135,000
J Brooks	**1,189,360**	750,000
T Brown*	**1,496,460**	1,496,460
P Magowan	**1,297,860**	1,108,000
M Muller*	**1,891,860**	1,891,860
D Dunn	**48,000**	48,000
P Cawdron	**98,000**	98,000
J Scarisbrick*	**10,800**	–
L Tesler	**105,000**	120,000

* Comparative figures for T Brown's, M Muller's and J Scarisbrick's shareholdings are as at their date of appointment to the board.

In addition to the interests disclosed above, all of the executive directors (together with all of the employees of the group) are potential beneficiaries of both the ARM Holdings plc Employee Share Ownership Trust and the ARM Holdings plc Qualifying Employee Share Ownership Trust. They are, therefore, treated as interested in all the shares held by these trusts, being 5,000,000 ordinary shares and 2,017,599 ordinary shares respectively at 31 December 2001 and 5,000,000 and 5,942,999 shares respectively at 31 December 2000. There have been no changes in directors' interests to the date of approval of the remuneration report.

Options over shares in Company

Details of options held by directors are set out below:

Director	As at 1 January 2001 Number	Granted Number	Exercised Number	**As at 31 December 2001 Number**	Exercise price £	Earliest date of exercise	Expiry date
R Saxby	600,000	–	–	**600,000**	0.02	15/07/99	14/07/03**
	140,000	–	–	**140,000**	1.224	11/03/02	10/03/06**
	25,000	–	–	**25,000**	6.155	22/05/01	21/05/07†
	765,000	–	–	**765,000**			
W East	131,520	–	–	**131,520**	1.224	11/03/02	10/03/06**
	8,480	–	–	**8,480**	1.224	11/03/02	10/03/09*
	3,187	–	–	**3,187**	6.155	22/05/03	21/05/10*
	20,962	–	–	**20,962**	6.155	22/05/01	21/05/07†
	–	62,909	–	**62,909**	3.815	22/05/04	21/05/08**
	164,149	62,909	–	**227,058**			
J Brooks	1,500,000	–	(1,500,000)	**–**	0.026	05/03/00	04/03/04**
	140,000	–	–	**140,000**	1.224	11/03/02	10/03/06**
	4,874	–	–	**4,874**	6.155	22/05/03	21/05/10*
	20,126	–	–	**20,126**	6.155	22/05/01	21/05/07†
	1,665,000	–	(1,500,000)	**165,000**			
T Brown	140,000	–	–	**140,000**	1.224	11/03/02	10/03/06**
	3,736	–	–	**3,736**	6.155	22/05/03	21/05/10*
	21,264	–	–	**21,264**	6.155	22/05/01	21/05/07†
	2,091	–	–	**2,091**	3.35	14/05/04	13/05/11*
	22,909	–	–	**22,909**	3.35	14/05/04	13/05/08**
	190,000††	–	–	**190,000**			

Options over shares in Company continued

Director	As at 1 January 2001 Number	Granted Number	Exercised Number	**As at 31 December 2001 Number**	Exercise price £	Earliest date of exercise	Expiry date
P Magowan	600,000	–	(600,000)	**–**	0.026	05/03/00	04/03/04**
	138,040	–	–	**138,040**	1.224	11/03/02	10/03/06**
	1,960	–	–	**1,960**	1.224	11/03/02	10/03/09*
	4,484	–	–	**4,484**	6.155	22/05/03	21/05/10*
	13,881	–	–	**13,881**	6.155	22/05/01	21/05/07†
	–	62,909	–	**62,909**	3.815	22/05/04	21/05/08**
	758,365	62,909	(600,000)	**221,274**			
M Muller	140,000	–	–	**140,000**	1.224	11/03/02	10/03/06**
	3,736	–	–	**3,736**	6.155	22/05/03	21/05/10*
	17,615	–	–	**17,615**	6.155	22/05/01	21/05/07†
	2,091	–	–	**2,091**	3.35	14/05/04	13/05/11*
	22,909	–	–	**22,909**	3.35	14/05/04	13/05/08**
	186,351††	–	–	**186,351**			

* Denotes share options issued under the Company's approved share option scheme.

** Denotes share options issued under the Company's unapproved share option scheme.

† Denotes share options issued under the Company's unapproved share option scheme which are exerciseable as follows: 25% maximum on first anniversary, 50% maximum on second anniversary, 75% maximum on third anniversary, 100% maximum on fourth anniversary.

†† Denotes number of share options held on 12 October 2001, the date of appointment of T Brown and M Muller.

No options lapsed in the year.

The share options issued to Warren East and Peter Magowan in May 2001 have performance conditions attached to them. These share options normally vest after seven years. If however, the Company achieves real EPS growth of 10% above the rate of inflation per annum for a period of three years, then all the options will be exercisable after three years.

Save As You Earn options over shares in the Company

Details of options held by directors under the Company's Save As You Earn option schemes are set out below:

Director	As at 1 January 2001 Number	Granted Number	Exercised Number	**As at 31 December 2001 Number**	Exercise price £	Earliest date of exercise	Expiry date
R Saxby	39,860	–	39,860	**–**	0.2445	01/06/01	30/11/01
	–	3,157	–	**3,157**	3.0685	01/07/04	31/12/04
W East	19,920	–	19,920	**–**	0.2445	01/06/01	30/11/01
	–	3,157	–	**3,157**	3.0685	01/07/04	31/12/04
J Brooks	39,860	–	39,860	**–**	0.2445	01/06/01	30/11/01
T Brown*	–	3,157	–	**3,157**	3.0685	01/07/04	31/12/04
P Magowan	39,860	–	39,860	**–**	0.2445	01/06/01	30/11/01
	–	3,157	–	**3,157**	3.0685	01/07/04	31/12/04

*Denotes number of share options held on 12 October 2001, the date of appointment of T Brown as director.

The gains made by Jonathan Brooks on the exercise of share options were £4,971,000 (2000: £15,414,800). The share price on the date of exercise was £3.34. The gains made by Peter Magowan on the exercise of share options were £1,988,400 (2000: £nil). The share price on the date of exercise was £3.34. The gains made by Robin Saxby on the exercise of shares granted under the Save As You Earn Scheme were £126,177 (2000: £nil). The share price on the date of exercise was £3.41. The gains made by Jonathan Brooks on the exercise of shares granted under the Save As You Earn Scheme were £126,177 (2000: £nil). The share price on the date of exercise was £3.41. The gains made by Warren East on the exercise of shares granted under the Save As You Earn Scheme were £79,590 (2000: £nil). The share price on the date of exercise was £4.24. The gains made by Peter Magowan on the exercise of shares granted under the Save As You Earn Scheme were £95,186 (2000: £nil). The share price on the date of exercise was £2.64.

Save As You Earn options over shares in the Company continued

The market value of the shares of the Company as at 31 December 2001 was £3.59. The closing mid-price ranged from £2.01 to £5.67 during the year.

The Company has no long-term incentive schemes.

Directors' emoluments

The emoluments of the directors of the Company in respect of services to the group were paid through its wholly-owned subsidiary, ARM Limited, and were as follows:

Director	Fees £	Basic salary £	Benefits £	Bonus payments £	Subtotal £	Pension contributions £	**Total 2001 £**	Total 2000 £
Executive								
R Saxby	–	254,000	11,952	80,518	346,470	23,625	**370,095**	363,535
W East	–	120,000	11,532	38,040	169,572	9,450	**179,022**	58,828
J Brooks	–	157,000	11,532	49,769	218,301	9,450	**227,751**	236,345
T Brown*	–	23,183	2,499	33,919	59,601	2,047	**61,648**	–
P Magowan	–	120,000	11,532	38,040	169,572	9,450	**179,022**	62,181
M Muller*	–	20,800	2,851	30,432	54,083	2,048	**56,131**	–
J Urquhart*	–	122,983	9,033	–	132,016	7,403	**139,419**	223,649
Total	–	817,966	60,931	270,718	1,149,615	63,473	**1,213,088**	944,538
Non-executive								
P Cawdron	22,000	–	–	–	22,000	–	**22,000**	20,000
D Dunn	22,000	–	–	–	22,000	–	**22,000**	20,000
J Scarisbrick**	7,333	–	–	–	7,333	–	**7,333**	–
L Tesler	22,000	–	–	–	22,000	–	**22,000**	20,000
Total	73,333	–	–	–	73,333	–	**73,333**	60,000
Total	73,333	817,966	60,931	270,718	1,222,948	63,473	**1,286,421**	1,004,538

* For T Brown and M Muller, salaries shown are from date of appointment on 12 October 2001 but bonuses paid at the end of the year reflect the full year's performance. For J Urquhart, salary shown is up to his date of resignation from the board on 12 October 2001.

** Fees are from date of appointment.

All the executive directors are accruing benefits under a money purchase pension scheme as a result of their services to the group, contributions for which were all paid during the year.

Warren East is deferring his bonus under the terms of the bonus scheme.

Doug Dunn OBE Chairman of the Remuneration Committee

Independent auditors' report/UK format

Independent auditors' report to the members of ARM Holdings plc We have audited the financial statements which comprise the consolidated profit and loss account, the statement of group total recognised gains and losses, the consolidated and Company balance sheets, the consolidated cash flow statement and the related notes.

Respective responsibilities of directors and auditors The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only "ARM at a glance", the Chairman's and Chief Executive Officer's review, the review of operations, "Directors and advisers", the financial review, the report of the board on remuneration, the directors' report, the corporate governance report, "Group Directory" and the selected financial data.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's or group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the group at 31 December 2001 and of the profit and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers.

PricewaterhouseCoopers Chartered Accountants and Registered Auditors
Cambridge
11 February 2002

Consolidated profit and loss account/UK format

For the year ended 31 December 2001

	Notes	2001 £000	2000 £000
Turnover	2	**146,274**	100,730
Cost of sales		**(17,289)**	(11,647)
Gross profit		**128,985**	89,083
Operating expenses			
Research and development		**(38,920)**	(27,518)
Sales and marketing		**(21,448)**	(18,060)
Administrative expenses		**(22,835)**	(12,349)
Total operating expenses		**83,203**	57,927
Group operating profit		**45,782**	31,156
Share of operating loss of associated undertaking		**–**	(85)
Total operating profit		**45,782**	31,071
Net gain on disposal of fixed asset trade investments	11	**314**	–
Gain on part disposal of associated undertaking		**–**	512
Interest receivable and similar income		**4,470**	3,912
Profit on ordinary activities before taxation	2, 5	**50,566**	35,495
Tax on profit on ordinary activities	6	**(15,606)**	(5,032)
Profit on ordinary activities after taxation		**34,960**	30,463
Equity minority interest	21	**(303)**	(192)
Retained profit for the financial year	19	**34,657**	30,271
Earnings per 0.05 pence ordinary share	8		
Basic		**3.5p**	3.1p
Diluted		**3.4p**	2.9p
Supplementary earnings per 0.05 pence ordinary share	8		
Basic		**3.7p**	2.7p
Diluted		**3.6p**	2.5p

All activities relate to continuing operations, which include the results of the acquisition in the year integrated into the group. See note 18.

There is no difference between the profit on ordinary activities before taxation and the retained profit for the year stated above and their historical cost equivalents.

Statement of group total recognised gains and losses/UK format

	Notes	2001 £000	2000 £000
Profit for the financial year		**34,657**	30,271
Foreign exchange difference on consolidation	19, 20	**14**	75
Total recognised gains and losses for the year		**34,671**	30,346

Consolidated balance sheet/UK format
As at 31 December 2001

	Notes	2001 £000	2000 £000
Fixed assets			
Intangible assets	9	**12,427**	5,578
Tangible assets	10	**22,668**	14,874
Investments	11	**5,943**	7,435
		41,038	27,887
Current assets			
Stocks	12	**581**	385
Debtors	13	**31,620**	24,350
Short-term investments	15	**94,376**	69,483
Cash at bank and in hand	15	**10,091**	5,783
		136,668	100,001
Creditors: amounts falling due within one year	14	**(39,360)**	(26,065)
Net current assets		**97,308**	73,936
Total assets less current liabilities		**138,346**	101,823
Provisions for liabilities and charges	16	**(210)**	(219)
Net assets	2	**138,136**	101,604
Capital and reserves			
Called-up share capital	17	**507**	500
Share premium account	19	**76,124**	74,573
Other reserves	19	**144**	130
Profit and loss account	19	**60,752**	26,095
Equity shareholders' funds	20	**137,527**	101,298
Minority interest – equity	21	**609**	306
Capital employed		**138,136**	101,604

The financial statements on pages 28 to 50 were approved by the board of directors on 11 February 2002 and were signed on its behalf by:

Robin Saxby Director

Company balance sheet/UK format
As at 31 December 2001

	Notes	**2001 £000**	2000 £000
Fixed assets			
Investments	11	**2,388**	3,346
Current assets			
Debtors	13	**35,708**	36,504
Short-term investments		**42,324**	37,671
Cash at bank and in hand		**18**	132
		78,050	74,307
Creditors: amounts falling due within one year	14	**(255)**	–
Net current assets		**77,795**	74,307
Net assets		**80,183**	77,653
Capital and reserves			
Called-up share capital	17	**507**	500
Share premium account	19	**76,124**	74,573
Profit and loss account	19	**3,552**	2,580
Equity shareholders' funds		**80,183**	77,653

The financial statements on pages 28 to 50 were approved by the board of directors on 11 February 2002 and were signed on its behalf by:

Robin Saxby Director

Consolidated cash flow statement/UK format
For the year ended 31 December 2001

	Notes	2001 £000	2000 £000
Net cash inflow from operating activities	22	**57,001**	41,892
Returns on investments and servicing of finance			
Interest received		**4,604**	3,775
Net cash inflow from returns on investments and servicing of finance		**4,604**	3,775
Taxation			
Withholding tax paid		**(2,149)**	(2,468)
UK corporation tax paid		**(7,129)**	(123)
Overseas tax paid		**(365)**	(337)
Tax paid		**(9,643)**	(2,928)
Capital expenditure and financial investment			
Purchase of fixed asset investments		**–**	(4,088)
Sale of fixed asset investments		**1,936**	–
Purchase of tangible fixed assets		**(17,349)**	(11,842)
Sale of tangible fixed assets		**71**	59
Purchase of intangible fixed assets		**(8,568)**	(2,822)
Proceeds received by QUEST on allocation of own shares held		**958**	–
Net cash outflow for capital expenditure and financial investment		**(22,952)**	(18,693)
Acquisitions and disposals			
Receipt from partial disposal of associated undertaking		**–**	517
Purchase of subsidiary undertakings	25	**–**	(3,057)
Purchase of assets and trade	25	**(1,351)**	(375)
Net cash acquired with subsidiary undertakings	25	**–**	18
Net cash outflow from acquisitions and disposals		**(1,351)**	(2,897)
Net cash inflow before management of liquid resources and financing		**27,659**	21,149
Management of liquid resources			
Purchase of short-term investments	23	**(24,893)**	(23,476)
Financing			
Issue of shares		**1,558**	2,320
		1,558	2,320
Increase/(decrease) in cash	23	**4,324**	(7)

Details of the group's net funds are shown in note 23.

1 Principal accounting policies

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been reviewed by the board of directors in accordance with Financial Reporting Standard (FRS) 18, "Accounting policies", and have been applied consistently, is set out below.

Basis of accounting The financial statements are prepared in accordance with the historical cost convention.

Basis of consolidation The consolidated profit and loss account and balance sheet include the financial statements of the Company and its subsidiary undertakings made up to 31 December 2001. Intra-group transactions and profits are eliminated fully on consolidation.

Associated undertakings Companies in which the group has a participating interest are treated as associated undertakings. The group's profit and loss account, balance sheet and cash flow statement have been presented in accordance with the requirements of FRS 9, "Associates and joint ventures". During 2000 the group made a partial disposal of its participating interest in Palmchip Corporation with the result that the remaining interest is no longer treated as an associated undertaking. The consolidated profit and loss account in 2000 includes the group's share of profits less losses of the associated undertaking up to the date of partial disposal. The group had no associated undertakings at 31 December 2001 or 31 December 2000.

Goodwill and intangible assets Purchased goodwill, being the difference between the fair value of consideration and the fair value of net assets acquired, is capitalised and amortised on a straight-line basis over an estimate of the time that the group is expected to benefit from it. Goodwill amortisation periods are determined on a case-by-case basis (see note 9). Provision is made against the carrying value of goodwill where an impairment in value is deemed to have occurred.

Licences and patents purchased for the use of technology are capitalised and amortised over the period in which the group is expected to benefit from the licence. These periods range from three to five years.

Trade investments Trade investments are included at cost. There is a regular review of the carrying value of investments, with reference to relevant financial information and industry conditions; impairment charges are recorded if there is evidence of impairment in value.

Short-term investments Bank deposits, which are not repayable on demand, are treated as short-term investments in accordance with FRS 1, "Cash flow statements". Movements in such investments are included under "management of liquid resources" in the group's cash flow statement.

Pension scheme arrangements The group contributes to defined contribution plans, covering substantially all employees in Europe and the US and to government pension schemes for employees in Japan, South Korea, Taiwan and Israel. The group contributes to these plans based upon various fixed percentages of employee compensation and such contributions are expensed as incurred.

Tangible fixed assets The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight-line basis over the expected useful economic lives of the assets concerned. Tangible fixed assets are carried at cost and are depreciated from the date that they come into use. The principal useful economic lives used for this purpose are:

Freehold buildings	25 years
Leasehold improvements	Five years or term of lease, whichever is shorter
Computers and software	Three years
Fixtures and fittings	Five to ten years
Motor vehicles	Four years

Provision is made against the carrying value of tangible fixed assets where an impairment in value is deemed to have occurred.

Operating leases Costs in respect of operating leases are charged on a straight-line basis over the lease term.

Stocks Stocks are stated at the lower of cost and net realisable value. In general, cost is determined on a first-in-first-out basis and includes transport and handling costs. Where necessary, provision is made for obsolete, slow-moving and defective stocks.

Turnover Turnover (excluding VAT) comprises the value of sales of licences, royalties arising from the resulting sale of licensed products, revenues from support, maintenance and training, and consulting contracts and the sale of boards and software toolkits.

Each licence is designed to meet the specific requirements of each customer. Delivery generally occurs within a short time period after signing. Licence fees are invoiced according to an agreed set of milestone payments. Typically the first milestone is on signing of the contract, the second is on delivery of the customised technology and the third is related to acceptance of the technology by the licensee.

Where agreements involve multiple elements, the entire fee from such arrangements has been allocated to each of the individual elements based on each element's fair value. Vendor specific objective evidence of fair value is determined by reference to licence agreements with other customers where elements are sold separately. Revenue from the sale of licences is recognised on a percentage-to-completion basis over the period from signing of the licence to customer acceptance. Under the percentage-to-completion method, provisions for estimated losses on uncompleted contracts are recognised in the period in which the likelihood of such losses is determined. The percentage to completion is measured by monitoring progress using records of actual time incurred to date in the project compared with the total estimated project requirement, which corresponds to the costs of earned revenues.

1 Principal accounting policies continued

Agreements including rights to unspecified products have been accounted for using subscription accounting, revenue from the arrangement being recognised over either the term of the arrangement or an estimate of the economic life of the products offered, beginning with the delivery of the first product.

In addition to the licence fees, contracts generally contain an agreement to provide post contract support. Fees for post contract support, which take place after customer acceptance, are specified in the contract. The fees are determined based on the group's price list as if sold separately. The price list is established and regularly reviewed by management. Revenue for post contract support is recognised on a straight-line basis over the period for which support and maintenance is contractually agreed by the group with the licensee.

The excess of licence fees invoiced over revenue recognised in respect of such fees is recorded as deferred income.

Revenue from consultancy is recognised when obligations are fulfilled; revenue from the sale of development systems is recognised when goods are delivered; and royalty revenue is recognised when notification is received from the customer of product sales, normally in arrears. Where necessary, the costs associated with providing post contract support on development system sales have been accrued.

Deferred taxation Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability or asset will crystallise. The provisions of FRS 19, "Deferred tax", will be adopted in 2002.

Foreign currency The assets and liabilities of subsidiaries denominated in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year.

Profit and loss accounts of overseas subsidiary undertakings are translated at the average exchange rate for the year. Differences on exchange arising from the retranslation of the opening net investment in subsidiary companies are taken to reserves and reported in the statement of group total recognised gains and losses.

Other transactions denominated in foreign currencies have been translated into sterling at actual rates of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been translated at rates ruling at the balance sheet date. Exchange differences have been included in operating profit.

Financial instruments The group attempts to reduce its foreign currency exposure by entering into forward contracts to sell US dollars and buy sterling. The group accounts for these instruments by revaluing the financial instruments and the associated trade debtors and cash at the year-end rate. The resulting gain or loss is credited or charged to the profit and loss account for the year.

Research and development All research and development expenditure is written off in the year in which it is incurred.

Share schemes The group's Employee Share Ownership Plan (ESOP) and Qualifying Employee Share Ownership Trust (QUEST) are separately administered trusts which are funded by loans (the ESOP) and loans and gifts (the QUEST) from the group, and the assets of which comprise shares in the Company. Shares in the Company held by the ESOP are shown at the lower of cost and market value. Shares in the QUEST are shown at their estimated recoverable amount being the option price of the shares payable by employees. The amounts contributed to the QUEST in excess of the option price are charged against reserves.

The Company operates a Save As You Earn scheme together with a similar scheme for US employees that allows the grant of share options at a discount to the market price at the date of grant. The Company has made use of the exemption under Urgent Issues Task Force Abstract 17 not to recognise any compensation charge in respect of these options.

Employer's National Insurance and similar taxes arise on the exercise of certain share options. In accordance with Urgent Issues Task Force Abstract 25 a provision is made, calculated using the market price of the Company's shares at the balance sheet date, pro-rated over the vesting period of the options.

Grants Grants in respect of specific research and development projects are credited to the profit and loss account to match the projects' related expenditure.

Changes in presentation of financial information FRS 17, "Retirement benefits", has been adopted with no resulting change in presentation because the group does not have any defined benefit schemes. FRS 19, "Deferred tax", was not adopted in 2001 and will be adopted in the next accounting period in line with the effective date of this standard.

2 Segmental analysis

The directors are of the opinion that the group has only one class of business. The group's operations by geographical area are as follows:

Turnover by destination

	2001 £000	2000 £000
Europe	**27,103**	20,616
US	**72,271**	55,233
Asia Pacific	**46,900**	24,881
	146,274	100,730

Turnover by origin

	2001			2000		
	Total sales £000	**Inter-segment sales £000**	**External sales £000**	Total sales £000	Inter-segment sales £000	External sales £000
Europe	**142,614**	**(11,478)**	**131,136**	98,678	(8,430)	90,248
US	**27,949**	**(19,518)**	**8,431**	21,017	(15,409)	5,608
Asia Pacific	**9,579**	**(2,872)**	**6,707**	7,285	(2,411)	4,874
	180,142	**(33,868)**	**146,274**	126,980	(26,250)	100,730

Profit before taxation, by origin

	2001 £000	2000 £000
Europe	**46,502**	32,795
US	**957**	1,152
Asia Pacific	**3,107**	1,548
	50,566	35,495

Net assets

	2001 £000	2000 £000
Europe	**128,249**	94,994
US	**5,363**	4,353
Asia Pacific	**4,524**	2,257
	138,136	101,604

3 Directors' emoluments

The aggregate emoluments of the directors of the Company are set out below:

	2001 £	2000 £
Aggregate emoluments in respect of qualifying services	**1,222,948**	959,875
Aggregate gains made on exercise of share options	**7,386,530**	48,324,730
	8,609,478	49,284,605
Aggregate Company pension contributions to money purchase schemes	**63,473**	44,663
	8,672,951	49,329,268

The emoluments of the highest-paid director of the Company are set out below:

	2001 £	2000 £
Emoluments in respect of qualifying services	**218,301**	340,660
Gains made on exercise of share options	**5,097,177**	21,878,150
	5,315,478	22,218,810
Company pension contributions to money purchase schemes	**9,450**	22,875
	5,324,928	22,241,685

Detailed disclosures of directors' emoluments are shown on page 26. Details of directors' interests in share options are shown on pages 24 and 25.

4 Employee information

The average monthly number of persons, including executive directors, employed by the group during the year was:

	2001 Number	2000 Number
By activity:		
Research and development	**409**	318
Administration	**87**	66
Sales and marketing	**182**	141
	678	525

	2001 £000	2000 £000
Staff costs (for the above persons):		
Wages and salaries	**37,360**	27,264
Social security costs	**2,989**	2,696
Other pension costs	**1,591**	1,160
	41,940	31,120

Of the total pension costs above, £nil (2000: £nil) remained unpaid at the year end.

5 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	2001 £000	2000 £000
Depreciation charge for the year:		
Tangible owned fixed assets	**9,327**	6,246
Amortisation of goodwill	**1,979**	1,309
Amortisation of other intangible assets	**1,091**	234
Auditors' remuneration:		
Audit services (Company £5,000 (2000: £5,000))	**146**	140
Non-audit services	**183**	158
Hire of plant and machinery – operating leases	**163**	79
Leased buildings – operating leases	**2,938**	2,667

In 2001 non-audit fees were £183,000 (2000: £158,000) and related to tax compliance and advisory work £63,000 (2000: £39,000), interim reviews, SEC-related work and accounting advice £36,000 (2000: £89,000), royalty audits £50,000 (2000: £nil) and other advisory work £34,000 (2000: £30,000).

Fees to other major firms of accountants for non-audit services amounted to £207,000 (2000: £293,000).

6 Tax on profit on ordinary activities

	2001 £000	2000 £000
UK corporation tax at 30% (2000: 30%):		
Current	**14,616**	5,413
(Over)/under provision in respect of prior years	**(114)**	39
Other	**–**	(484)
	14,502	4,968
Overseas corporation tax:		
Current	**1,013**	680
Deferred	**91**	(415)
(Over) provision in respect of prior years:		
Current	**–**	(201)
Subtotal	**1,104**	64
	15,606	5,032

The taxation charge for 2001 was reduced by £537,000 (2000: £585,000) in relation to tax losses generated by overseas subsidiaries.

The taxation charge for 2000 was reduced by £5,331,000 following contributions of £17,787,000 to the group's QUEST as detailed in note 11. There was no contribution to the group's QUEST in 2001.

7 Profit for the financial year

As permitted by Section 230 of the Companies Act 1985, the parent company's profit and loss account has not been included in these financial statements. The parent company's profit after taxation, including dividends receivable and before dividends payable was £972,000 (2000: £14,610,000).

8 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding those held in the ESOP and the QUEST which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company had one category of dilutive potential ordinary shares during the year, being those share options granted to employees where the exercise price is less than the market price of the Company's ordinary shares during the year.

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below:

	2001			2000		
	Earnings £000	**Number of shares Thousands**	**Per share amount**	Earnings £000	Number of shares Thousands	Per share amount
Basic EPS						
Profit available to ordinary shareholders	**34,657**	**999,742**	**3.5p**	30,271	970,947	3.1p
Effect of dilutive securities:						
Options	**–**	**24,891**		–	57,329	
Diluted EPS						
Adjusted earnings	**34,657**	**1,024,633**	**3.4p**	30,271	1,028,276	2.9p

Supplementary earnings per share to exclude the tax effect of contributions to the QUEST and goodwill amortisation

	2001			2000		
	Earnings £000	**Number of shares Thousands**	**Per share amount**	Earnings £000	Number of shares Thousands	Per share amount
Basic EPS	**34,657**	**999,742**	**3.5p**	30,271	970,947	3.1p
Tax effect of payment to QUEST	**–**	**–**	**–**	(5,331)	–	(0.5p)
Amortisation of goodwill	**1,979**	**–**	**0.2p**	1,309	–	0.1p
Basic EPS excluding tax effect of QUEST and goodwill amortisation	**36,636**	**999,742**	**3.7p**	26,249	970,947	2.7p
Diluted EPS	**34,657**	**1,024,633**	**3.4p**	30,271	1,028,276	2.9p
Tax effect of payment to QUEST	**–**	**–**	**–**	(5,331)	–	(0.5p)
Amortisation of goodwill	**1,979**	**–**	**0.2p**	1,309	–	0.1p
Diluted EPS excluding tax effect of QUEST and goodwill amortisation	**36,636**	**1,024,633**	**3.6p**	26,249	1,028,276	2.5p

As explained in note 6, the group's profit after tax in 2000 was reduced following contributions of £17,787,000 to the group's QUEST. Supplementary basic and diluted EPS have been calculated to exclude both this effect and the effect of goodwill amortisation in respect of the group's acquisitions. The adjusted numbers have been provided in order that the effects of the items on reported earnings per share can be fully appreciated. There were no contributions to the group's QUEST in 2001.

9 Intangible fixed assets

Group	Patents and licences £000	Goodwill £000	Total £000
Cost			
At 1 January 2001	2,822	4,393	7,215
Additions (note 18)	8,568	1,351	9,919
At 31 December 2001	**11,390**	**5,744**	**17,134**
Aggregate amortisation			
At 1 January 2001	234	1,403	1,637
Charge for the year	1,091	1,979	3,070
At 31 December 2001	**1,325**	**3,382**	**4,707**
Net book value			
At 31 December 2001	**10,065**	**2,362**	**12,427**
At 31 December 2000	2,588	2,990	5,578

The Company does not own any intangible fixed assets.

The group acquired part of the assets and trade of Noral Micrologics Limited during the year (see note 18). The goodwill arising is being amortised over three years.

The group acquired patents during the year which are being amortised over five years.

Goodwill arising on previous years' acquisitions is being written off over two years (in the case of Micrologic Solutions Limited and ARM France SAS (formerly EuroMips Systems SAS)) and three years in the case of Allant Software Corporation.

10 Tangible fixed assets

Group	Freehold buildings £000	Assets under construction £000	Leasehold improvements £000	Computers and software £000	Fixtures, fittings and motor vehicles £000	Total £000
Cost						
At 1 January 2001	190	1,596	6,354	21,850	2,434	32,424
Exchange differences	–	–	16	37	14	67
Additions	–	75	3,897	12,808	569	17,349
Transfer	–	(1,596)	1,596	–	–	–
Disposals	–	–	–	(352)	(198)	(550)
At 31 December 2001	**190**	**75**	**11,863**	**34,343**	**2,819**	**49,290**
Aggregate depreciation						
At 1 January 2001	15	–	1,924	14,271	1,340	17,550
Exchange differences	–	–	5	24	8	37
Charge for year	8	–	2,551	6,380	388	9,327
Disposals	–	–	–	(144)	(148)	(292)
At 31 December 2001	**23**	**–**	**4,480**	**20,531**	**1,588**	**26,622**
Net book value						
At 31 December 2001	**167**	**75**	**7,383**	**13,812**	**1,231**	**22,668**
At 31 December 2000	175	1,596	4,430	7,579	1,094	14,874

Assets under construction represent leasehold improvements.

The Company does not own any tangible fixed assets.

11 Fixed asset investments

Group	Listed investments £000	Other investments £000	Investment in own shares £000	Total £000
Cost				
At 1 January 2001	1,282	2,827	3,346	7,455
Additions	–	1,361	–	1,361
Disposals	(1,282)	(20)	–	(1,302)
Shares allocated to satisfy exercises under SAYE scheme	–	–	(958)	(958)
At 31 December 2001	**–**	**4,168**	**2,388**	**6,556**
Amounts written off				
At 1 January 2001	–	20	–	20
Amounts written off	–	613	–	613
Disposals	–	(20)	–	(20)
At 31 December 2001	**–**	**613**	**–**	**613**
Net book value				
At 31 December 2001	**–**	**3,555**	**2,388**	**5,943**
At 31 December 2000	1,282	2,807	3,346	7,435

Listed investments During the year the group disposed of its investment in the share capital of Parthus Technologies plc, an intellectual property company which develops solutions for mobile-internet devices and applications. The group considered it prudent to limit its exposure in listed equity investments given the current volatility of world stock markets.

Other investments The group invested in two unlisted companies during the year, one of which was a 1.3% investment in the share capital of LinkUp Systems, Inc., a private fabless chip company based in California, and the other being a 1.7% investment in the share capital of Pixim, Inc., also a private fabless chip company based in California. Equity shares in both companies were received in settlement of trade debtors.

The group disposed of its 3% share of Sirius Communications NV, whose principal business activity is the design and sale of spread spectrum transceivers.

Also included in other investments is the Company's less than 1% holding in the share capital of Cambridge Silicon Radio Limited, an intellectual property company which develops Bluetooth solutions, and a 3.5% investment in the share capital of CoWare, Inc., a company which develops system-on-chip software for a wide range of applications.

Provisions have been made against other investments to reflect a permanent diminution in value. All these investments are held by ARM Limited.

Net gains on disposal of fixed asset trade investments The total gains on disposal of fixed asset investments were £655,000. Impairments against fixed asset investments which are committed to be sold at the year end amounted to £341,000. These result in a net gain on disposal of fixed asset trade investments of £314,000.

Investment in own shares Investment in own shares includes £1,438,000, being the cost of 5,000,000 shares in the Company held by the group's ESOP which are disclosed as a fixed asset investment in accordance with Urgent Issues Task Force Abstract 13, "Accounting for ESOP trusts". The trust was set up in 1998 and purchased shares at the time of the Company's flotation using funds provided by the Company. No options had been granted over these shares at 31 December 2001 and no awards have been made since the trust was created. As at 31 December 2001 and 2000 the trust held 5,000,000 shares (nominal value £2,500) with a market value of £17,950,000 at 31 December 2001 (2000: £25,300,000). All costs relating to the scheme are dealt with in the profit and loss account as they accrue and the trust has waived the right to receive dividends of over and above 0.01 pence per share on all shares held.

Investment in own shares held also includes £950,000 relating to 2,017,599 shares held by the group's QUEST, which was established by the Company during 1999 to acquire new shares in the Company for the benefit of employees and directors of the group. 2,042,999 shares were purchased in 2000 in two separate transactions detailed below. During the year 3,925,400 shares were allocated to satisfy employees' and directors' exercises under the Company's Save As You Earn Scheme.

The Company made no contributions to the QUEST in 2001. On 13 March 2000 and 7 November 2000, the Company provided £14,445,000 and £4,291,000 respectively for this purpose of which £14,018,000 and £3,769,000 respectively, being £17,787,000 in total, was by way of a gift and £427,000 and £522,000 respectively, being £949,000 in total, was by way of a loan. On the same dates, the QUEST subscribed at market value for 1,483,440 and 559,559 respectively of the Company's 0.05 pence ordinary shares. The shares rank pari passu in all respects with the existing ordinary shares. They will be allocated to employees and directors to satisfy their options granted under the Company's Save As You Earn option schemes. The cost of the gifts was transferred by the Company directly to the profit and loss account reserve. The excess of the subscription price over the nominal value of the shares issued, which amounts to £14,445,000 and £4,290,000 respectively, was taken to the share premium account.

The shares held by the QUEST at 31 December 2001 have been included in the group balance sheet, as investments in own shares, at a value of £950,000, which is equivalent to the amounts receivable from employees on exercise of their options. The market value of the shares at 31 December 2001 was £7,243,180 (2000: £30,072,000).

11 Fixed asset investments continued

The trust has waived the right to receive dividends on the shares held by the QUEST, and all costs relating to the scheme are dealt with in the profit and loss account as they accrue.

Company	Investments in own shares £000	Total £000
Cost and net book value		
At 1 January 2001	3,346	3,346
Shares allocated to satisfy exercises under SAYE scheme	(958)	(958)
At 31 December 2001	**2,388**	**2,388**

Investment in own shares comprises the shares held by the Company's ESOP and by the Company's QUEST, as described above.

Interests in group undertakings Details of subsidiary undertakings are as follows:

Name of undertaking	Country of registration	Description of shares held	Proportion of nominal value of issued shares held
ARM Limited	England and Wales	Ordinary £1 shares	100%
ARM QUEST Trustees Limited	England and Wales	Ordinary £1 shares	100%

The principal activity of ARM Limited is the marketing, research and development of RISC-based microprocessors. ARM QUEST Trustees Limited is the trustee company of the Company's QUEST.

The group holds the following investments in subsidiaries, via its subsidiary company, ARM Limited.

Name of undertaking	Country of registration	Principal activity	Proportion of nominal value of issued shares held
ARM, INC.	USA	Marketing and development of RISC-based processors	100%
ARM KK	Japan	Marketing of RISC-based processors	100%
ARM Korea Limited	South Korea	Marketing of RISC-based processors	85%
ARM Taiwan Limited	Taiwan	Marketing of RISC-based processors	99.9%
Micrologic Solutions Limited	England and Wales	Dormant	100%
Advanced RISC Machines Limited	England and Wales	Dormant	100%
Allant Software Corporation	USA	Dormant	100%
ARM France SAS	France	Development of RISC-based processors	100%

Nominees of the Company hold 100% of the ordinary share capital of ARM Employee Benefit Trustee Ltd, a company which acts as trustee to the group's ESOP.

12 Stocks

Group	**2001 £000**	2000 £000
Finished goods	**581**	385

The Company had no stocks at 31 December 2001 and 2000.

13 Debtors

	Group		Company	
	2001	2000	**2001**	2000
	£000	£000	**£000**	£000
Amounts falling due within one year				
Trade debtors	**24,809**	18,913	**–**	–
Amounts owed by group undertakings	**–**	–	**35,609**	36,258
Corporation tax	**550**	439	**–**	–
Other debtors	**1,308**	1,765	**–**	–
Deferred tax (see note 16)	**255**	346	**–**	–
Prepayments and accrued income	**4,698**	2,887	**99**	246
	31,620	24,350	**35,708**	36,504

14 Creditors: amounts falling due within one year

	Group		Company	
	2001	2000	**2001**	2000
	£000	£000	**£000**	£000
Trade creditors	**2,361**	2,049	**–**	–
Corporation tax	**7,054**	1,621	**232**	–
Other taxation and social security	**784**	590	**–**	–
Other creditors	**1,189**	180	**–**	–
Accruals and deferred income	**27,972**	21,625	**23**	–
	39,360	26,065	**255**	–

15 Financial instruments

Use of financial instruments – general The group has three primary objectives in its use of financial instruments, namely the management of foreign exchange risk, the maximisation of returns on funds held on deposit and the use of strategic trade investments in companies in order to further establish the ARM architecture. These are managed, respectively, through the use of hedging strategies (primarily forward contracts), money market instruments and an ongoing process of assessing potential trade investments and current holdings.

To meet these objectives the group has used the policies described below which have been applied throughout the current year.

Management of foreign exchange risk The group's earnings and liquidity are affected by fluctuations in foreign currency exchange rates, principally in respect of the US dollar, reflecting the fact that most of the group's revenues and cash receipts are denominated in US dollars, while the majority of its costs are settled in sterling. The group seeks to use forward contracts to manage the US dollar/sterling risk as appropriate, by monitoring the timing and value of anticipated US dollar receipts (which tend to arise from low-volume, high-value licence deals) in comparison with its requirement to settle certain expenses in US dollars. The group reviews the resulting exposure on a regular basis and hedges this exposure using forward contracts for the sale of US dollars as appropriate. Such contracts are entered into with the objective of matching their maturity with projected US dollar cash receipts. As the timing of large cash receipts cannot be predicted with certainty, the group enters into forward contracts which allow exercise between two dates, typically between three and four months from the invoice date. In those cases where customers settle debts before the expiry of the foreign exchange contract, the group evaluates whether money market rates available for US dollar investments exceed those for sterling investments. It then seeks to maximise its returns by remitting US dollars against forward contracts at the beginning or end of the exercise period, depending on the prevailing money market rates for US dollars and sterling at the time.

At 31 December 2001, the group had outstanding forward contracts to sell $42,800,000 (2000: $34,000,000). The group had $34,631,000 (2000: $25,600,000) of trade debtors denominated in US dollars at that date, and US dollar cash balances of $22,720,000 (2000: $18,220,000). Thus 24% (2000: 22%) of the group's US dollar current assets were not hedged by matching forward contracts at the year end, a proportion considered appropriate in the light of the anticipated US dollar requirements to settle liabilities, particularly in respect of overseas operations.

In addition, certain customers remit royalties and licence fees in other currencies, primarily the euro.

It is not the group's policy to remit the profits of foreign subsidiaries to the UK, but rather to invest those profits in the subsidiary in which they were earned. The group does not hedge any foreign net asset investment using foreign currency loans, as there is currently no requirement for external borrowings.

15 Financial instruments continued

Maximisation of return on funds held on deposit The group's earnings may be affected by changes in interest rates available on bank deposits. The group aims to maximise returns from funds held on deposit and uses money market deposits with major financial institutions to do so. Recent maturities have been up to three months in length, but this varies since close consideration is given to the UK and US money market yield curves before contracts are closed.

External borrowings The group had no long-term debt at 31 December 2001 (2000: £nil) or during the financial year.

Trade investments Investment activity is intended to create long-term strategic alliances with development companies, some of which may be unlisted at the time of the investment decision. As there can be no guarantee that there will be a future market for these securities or that the value of such investments will rise, the directors evaluate each investment opportunity on its merits before committing ARM's funds. The directors review holdings in such companies on a regular basis to determine whether continued investment is in the best interests of the group. Funds for such ventures are strictly limited in order that the financial effect of any potential decline in the value of investments would not be substantial in the context of the group's financial results. During 2001 the directors decided to limit the Company's exposure in listed equity investments given the current volatility of world stock markets and as such disposed of its holding in Parthus Technologies plc, its only listed equity investment.

The Company made two new investments in private companies, LinkUp Systems, Inc. and Pixim, Inc., developing products based on ARM technology during the year, LinkUp Systems, Inc. and Pixim, Inc. CoWare, Inc. and Cambridge Silicon Radio Limited, in which ARM has also invested, remain private companies at the year end.

Numerical disclosures Numerical disclosures are set out in the tables below. Short-term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures.

Interest rate risk of financial assets

	2001			2000		
Currency	Cash at bank and in hand £000	Short-term investments £000	Total £000	Cash at bank and in hand £000	Short-term investments £000	Total £000
Sterling	**999**	**85,855**	**86,854**	269	56,415	56,684
US dollars	**8,781**	**6,904**	**15,685**	4,659	7,534	12,193
EU currencies (other than sterling)	**280**	**1,617**	**1,897**	632	3,931	4,563
Other currencies	**31**	**–**	**31**	223	1,603	1,826
At 31 December	**10,091**	**94,376**	**104,467**	5,783	69,483	75,266
Floating rate	**10,091**	**–**	**10,091**	5,783	–	5,783
Fixed rate	**–**	**94,376**	**94,376**	–	69,483	69,483
At 31 December	**10,091**	**94,376**	**104,467**	5,783	69,483	75,266

The fixed rate cash and short-term investments in sterling and US dollars were placed with banks for between one week and three months and earn interest of between 1.65% and 6.1% (2000: 4% and 7%). Floating rate cash earns interest based on relevant national LIBID equivalents.

Financial liabilities Provisions of £210,000 are financial liabilities in sterling on which no interest is paid. Maturity depends on when certain share options are exercised.

Fair values of financial instruments

Cash and short-term investments The carrying amount approximates to fair value because of the short maturity of those instruments.

Foreign currency forward contracts The fair value of foreign currency contracts is estimated using the settlement rates. The fair value of forward contracts is estimated at £355,000 at 31 December 2001 (2000: £551,000). The small decrease is due to changes in the sterling/US dollar exchange rate in 2001.

Investments in unlisted companies Those companies in which ARM has invested are early-stage development enterprises, which are generating value for shareholders through research and development activities, and most do not currently report profits. The directors do not consider it possible to estimate with precision the fair value of its investments in unlisted companies (carrying value at 31 December 2001: £3,555,000) as they are, by definition, not traded on an organised market and are unique in their activities. Nevertheless, based on impairment reviews, carried out on a regular basis, the directors are of the opinion that the fair value of these investments approximates to carrying value.

Provisions The carrying amount of £210,000 approximates to fair value as this is the amount which would be payable if the liability had crystallised at the balance sheet date.

15 Financial instruments continued

Currency exposure The table below shows the extent to which group companies have monetary assets and liabilities in currency other than their local currency. Foreign exchange differences on retranslation of these assets and liabilities are taken to the profit and loss account of the group companies and the group.

2001	US dollars £000	EU currencies £000	Other currencies £000	Total £000
Functional currency of group operation				
Sterling	**29,244**	**3,224**	**(81)**	**32,387**
Other currencies	**4,594**	**–**	**–**	**4,594**
Total	**33,838**	**3,224**	**(81)**	**36,981**

2000				
Functional currency of group operation				
Sterling	25,646	5,038	152	30,836
Other currencies	33	–	–	33
Total	25,679	5,038	152	30,869

Hedges The group's hedging policy is to hedge currency risk using forward foreign currency contracts for foreign currency debtors. Details of unrecognised and deferred gains and losses are shown below:

	Unrecognised			Deferred		
	Gain £000	Loss £000	Total net gain/loss £000	Gain £000	Loss £000	Total net gain/loss £000
Gains and losses on hedges at 1 January 2001	–	–	–	551	–	551
Arising in previous years included in 2001 income	–	–	–	(551)	–	(551)
Gains and losses not included in 2001 income	–	–	–	–	–	–
Arising in 2001	–	–	–	355	–	355
Gains and losses on hedges at 31 December 2001	**–**	**–**	**–**	**355**	**–**	**355**
Of which:						
Gains and losses expected to be included in 2002 income	–	–	–	355	–	355

Gains deferred at 31 December 2001 will be matched by losses of the same amount on the underlying items being hedged.

Financial instruments held for trading purposes The group does not trade in financial instruments.

16 Provisions for liabilities and charges

The movement in the group's deferred tax asset and other provisions is as follows:

	Deferred tax 2001 £000	Other provisions 2001 £000	Total 2001 £000	Deferred tax 2000 £000	Other provisions 2000 £000	Total 2000 £000
At 1 January	**346**	**(219)**	**127**	(69)	–	(69)
(Charged)/credited to the profit and loss account	**(91)**	**9**	**(82)**	415	(219)	196
At 31 December	**255**	**(210)**	**45**	346	(219)	127

The deferred tax asset is included in debtors.

The other provision relates to employer's National Insurance and similar taxes on share options provided in accordance with Urgent Issues Taskforce Abstract 25.

The Company has no potential liability for deferred taxation. The analysis of deferred tax liabilities and assets for the group is as follows:

	Amount recognised		Amount not recognised	
	2001 £000	2000 £000	**2001 £000**	2000 £000
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	**–**	–	**584**	852
Losses carried forward	**–**	–	**1,397**	1,710
Other	**255**	346	**60**	–
	255	346	**2,041**	2,562

No provision is made for taxation liabilities which would arise on the distribution of profits retained by overseas subsidiaries because there is no intention in the foreseeable future that such profits will be remitted.

17 Called-up share capital

	2001 £000	2000 £000
Authorised		
1,580,000,000 ordinary shares of 0.05 pence each (2000: 1,580,000,000)	**790**	790
Allotted, called-up and fully paid		
1,014,767,176 ordinary shares of 0.05 pence each (2000: 1,000,235,371)	**507**	500

14,531,805 ordinary shares of 0.05 pence each were issued in the year for cash consideration of £1,558,000. The issue of these shares occurred on the exercise of share options at various times during the year.

Share options The Company had the following ordinary share options outstanding at 31 December 2001:

Date of issue	Ordinary shares of 0.05 pence each Number	Exercise price £	Period of option Earliest date	Period of option Latest date
15 July 1996	975,000	0.02	15 July 1999	14 July 2006
15 July 1996	600,000	0.02	15 July 1999	14 July 2003
5 March 1997	2,037,800	0.026	5 March 2000	4 March 2007
5 March 1997	58,030	0.026	5 March 1998	4 March 2002**
30 April 1997	15,000	0.026	30 April 1998	29 April 2002**
30 April 1997	8,000	0.026	30 April 2000	29 April 2004
29 May 1997	80,000	0.0425	29 May 2000	28 May 2004
25 June 1997	27,505	0.0625	25 June 1998	24 June 2002**
25 June 1997	70,000	0.0625	25 June 2000	24 June 2004
1 October 1997	15,001	0.0625	1 October 1998	30 September 2002**
1 October 1997	395,000	0.0625	1 October 2000	30 September 2004
24 December 1997	273,000	0.0625	24 December 2000	23 December 2004
7 March 1998	1,050,000	0.1125	7 March 2001	6 March 2008
7 March 1998	375,054	0.1125	7 March 1999	6 March 2003**
17 April 1998*	1,115,920	0.2445	1 June 2003	30 November 2003
8 June 1998	164,329	0.3875	8 June 1999	7 June 2003**

17 Called-up share capital continued

Date of issue	Ordinary shares of 0.05 pence each Number	Exercise price £	Period of option Earliest date	Period of option Latest date
8 June 1998	135,000	0.3875	8 June 2001	7 June 2005
17 August 1998	220,000	0.5275	17 August 2001	16 August 2008
17 August 1998	85,571	0.5275	17 August 1999	16 August 2003**
16 October 1998	103,000	0.405	16 October 2001	15 October 2008
16 October 1998	37,250	0.405	16 October 1999	15 October 2003**
11 March 1999	3,918,960	1.224	11 March 2002	10 March 2009
11 March 1999	2,319,918	1.224	11 March 2000	10 March 2004**
11 March 1999	7,148,040	1.224	11 March 2002	10 March 2006
4 May 1999	173,260	1.338	4 May 2002	3 May 2009
4 May 1999	42,740	1.338	4 May 2002	3 May 2006
4 May 1999	41,254	1.338	4 May 2000	3 May 2004**
10 June 1999*	137,530	1.099	1 July 2004	31 December 2004
10 June 1999*	356,605	1.099	1 July 2002	31 December 2002
10 August 1999	75,490	1.765	10 August 2002	9 August 2009
10 August 1999	50,004	1.765	10 August 2000	9 August 2004**
10 August 1999	26,010	1.765	10 August 2002	9 August 2006
12 November 1999	91,570	4.26	16 November 2002	15 November 2009
12 November 1999	76,680	4.26	16 November 2002	15 November 2006
1 February 2000	128,125	7.738	1 February 2003	31 January 2010
1 February 2000	52,500	7.738	1 February 2001	31 January 2005**
1 February 2000	76,125	7.738	1 February 2003	31 January 2007
18 April 2000	80,465	6.136	18 April 2003	17 April 2010
18 April 2000	10,000	6.136	18 April 2001	17 April 2005**
18 April 2000	36,035	6.136	18 April 2003	17 April 2007
25 April 2000	50,000	6.27	25 April 2001	24 April 2005**
19 May 2000*	42,225	5.65	1 July 2003	31 December 2003
19 May 2000*	4,896	5.65	1 July 2005	31 December 2005
19 May 2000*	3,681	5.65	1 July 2002	30 September 2002
22 May 2000	394,369	6.155	22 May 2003	21 May 2010
22 May 2000	840,500	6.155	22 May 2001	21 May 2005**
22 May 2000	2,859,842	6.155	22 May 2001	21 May 2007**
7 August 2000	24,250	6.70	7 August 2001	6 August 2005**
7 August 2000	170,000	6.70	7 August 2001	6 August 2007**
13 October 2000	145,750	6.33	13 October 2001	12 October 2005**
13 October 2000	275,000	6.33	13 October 2001	12 October 2007**
15 February 2001	88,000	4.43	15 February 2002	14 February 2006**
15 February 2001	444,000	4.43	15 February 2002	14 February 2008**
14 May 2001	625,725	3.35	14 May 2004	13 May 2011
14 May 2001	1,364,400	3.35	14 May 2002	13 May 2006**
14 May 2001	3,956,275	3.35	14 May 2002	13 May 2008**
19 May 2001*	651,677	3.069	1 July 2004	31 December 2004
19 May 2001*	144,393	3.069	1 July 2006	31 December 2006
19 May 2001*	204,841	3.069	1 July 2003	30 September 2003
22 May 2001	125,818	3.815	22 May 2008	21 May 2011†
1 August 2001	61,313	2.84	1 August 2004	31 July 2011
1 August 2001	28,000	2.84	1 August 2002	31 July 2006**
1 August 2001	25,822	2.84	1 August 2002	31 July 2008**
6 November 2001	142,250	3.75	6 November 2004	5 November 2011**
6 November 2001	44,750	3.75	6 November 2002	5 November 2006**
6 November 2001	51,000	3.75	6 November 2002	5 November 2008**
Total	**35,450,548**			

* These relate to options granted under the Company's savings related share option schemes.

** Options are exercisable as follows: 25% maximum on first anniversary, 50% maximum on second anniversary, 75% maximum on third anniversary, 100% maximum on fourth anniversary.

† These options will vest after seven years unless certain criteria are met, in which case they will vest between three and seven years.

18 Acquisitions

The group acquired part of the assets and trade of Noral Micrologics Limited on 1 February 2001 for cash consideration of £1,351,000. The whole amount of the purchase price has been treated as goodwill as both the book and fair values of the assets acquired were negligible.

In addition to the cash consideration for the cost of the acquisition, the acquisition agreement provides for cash bonuses and payments for post acquisition pre-defined services provided by employees. These are being treated as payroll costs of the periods to which the services relate, as required by FRS 7, "Fair values in acquisition accounting".

No indication can be given of the contribution to turnover and operating profit of the company since acquisition. This is because the business and assets of the company were integrated into those of another group company shortly after the purchase and it is not now possible to identify separately the results or turnover of that part of the business.

The profit or loss of the acquisition for the period from the beginning of its financial year to the date of its acquisition and for its previous financial year have not been disclosed as the acquisition is not considered material in relation to the group.

19 Share premium account and reserves

Group	Share premium account £000	Other reserves £000	Profit and loss account £000
At 1 January 2001	74,573	130	26,095
Foreign exchange difference on consolidation	–	14	–
Premium on exercise of share options	1,551	–	–
Retained profit for the year	–	–	34,657
At 31 December 2001	**76,124**	**144**	**60,752**

Other reserves represent exchange differences arising on consolidation of foreign subsidiary undertakings.

Company	Share premium account £000	Profit and loss account £000
At 1 January 2001	74,573	2,580
Premium on exercise of share options	1,551	–
Retained profit for the year	–	972
At 31 December 2001	**76,124**	**3,552**

20 Reconciliation of movements in shareholders' funds

Group	**2001 £000**	2000 £000
Profit attributable to shareholders	**34,657**	30,271
Other recognised gains and losses relating to the year	**14**	75
New share capital issued	**7**	20
Share premium on issue of new shares	**1,551**	21,036
Contribution to QUEST	**–**	(17,787)
Net addition to shareholders' funds	**36,229**	33,615
Opening shareholders' funds	**101,298**	67,683
Closing shareholders' funds	**137,527**	101,298

21 Minority interests

	2001 £000	2000 £000
At 1 January	**306**	114
Profit and loss account	**303**	192
Equity minority interests at 31 December	**609**	306

22 Reconciliation of operating profit to net cash inflow from continuing operating activities

	2001 £000	2000 £000
Operating profit	**45,782**	31,156
Depreciation on tangible fixed assets	**9,327**	6,246
Loss on sale of tangible fixed assets	**187**	70
Amortisation of goodwill	**1,979**	1,309
Amortisation of other intangible assets	**1,091**	234
(Increase) in stocks	**(196)**	(184)
(Increase) in trade debtors	**(5,896)**	(4,995)
Trade debtors converted to unlisted investments	**(1,361)**	–
Amounts written off unlisted investment	**272**	–
(Increase) in prepayments and accrued income	**(2,037)**	(859)
Increase in trade creditors	**312**	957
Increase in other taxation and social security	**194**	77
Increase in accruals, deferred income and other creditors	**7,338**	7,662
Movement on provisions for liabilities and charges	**9**	219
Net cash inflow from operating activities	**57,001**	41,892

23 Reconciliation of net cash flow to movement in net funds

	2001 £000	2000 £000
Increase/(decrease) in cash for the year	**4,324**	(7)
Cash outflow from purchase of short-term investments	**24,893**	23,476
Change in net funds from cash flows	**29,217**	23,469
Non-cash items:		
Translation difference	**(16)**	(7)
Movement in net funds in the year	**29,201**	23,462
Net funds at start of the year	**75,266**	51,804
Net funds at end of the year	**104,467**	75,266

24 Analysis of net funds

	Cash at bank and in hand £000	Short-term investments £000	Total £000
At 1 January 2001	5,783	69,483	75,266
Cash flow	4,324	24,893	29,217
Translation differences	(16)	–	(16)
At 31 December 2001	**10,091**	**94,376**	**104,467**

25 Cash flow from acquisitions

	2001 £000	2000 £000
Acquisitions		
Purchase of subsidiary undertakings	**–**	(2,888)
Purchase of assets and trade	**(1,200)**	(375)
Acquisition expenses	**(151)**	(169)
Cash at bank and in hand acquired with subsidiaries	**–**	18
Net cash outflow from acquisitions	**(1,351)**	(3,414)

26 Capital commitments

Group	2001 £000	2000 £000
Capital expenditure that has been contracted for but has not been provided for in the financial statements	**488**	3,797

The Company had no capital commitments at 31 December 2001 and 2000.

27 Financial commitments

At 31 December 2001 the group had annual commitments under non-cancellable operating leases as follows:

	2001		2000	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
Expiring within one year	**369**	**–**	342	10
Expiring between two and five years inclusive	**957**	**57**	1,116	44
Expiring in over five years	**2,110**	**–**	1,421	–
	3,436	**57**	2,879	54

At 31 December 2001 and 2000 the Company had no annual commitments under non-cancellable operating leases.

The group has an obligation to make a $3,000,000 investment representing a minority holding in a "fabless" semiconductor company in the event that this is set up during 2002 to create and sell ARM-based microprocessor cores to be licensed from ARM.

28 Related party transactions

The Company has taken advantage of the exemption from disclosure available to parent companies under FRS 8, "Related party disclosures", where transactions and balances between group entities have been eliminated on consolidation.

Until the partial disposal of Palmchip Corporation in 2000 the directors regarded the company as a related party by virtue of it being an associated undertaking; in 2000, prior to the partial disposal, Palmchip repaid a loan of £248,000 previously made to it by ARM Limited. No disclosure has been made of transactions since Palmchip Corporation ceased to be a related party.

29 Summary of significant differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) followed by the group and United States Generally Accepted Accounting Principles (US GAAP)

The financial information set out in this report has been prepared under UK GAAP which differs in certain significant respects from US GAAP. The principal differences between the group's accounting policies under UK GAAP and those that would have been followed had the financial information been prepared under US GAAP are set out below.

Employee share options Under both UK and US GAAP, if options are issued at below fair market value there is a compensation cost. Under US GAAP, this cost is charged to the profit and loss account over the vesting period of the options. The conventions used to determine the fair market value can be, and in this case are, different under US GAAP, resulting in no charge for the Company under UK GAAP but a charge for the Company under US GAAP, for options issued in the period from March 1997 to March 1998.

Under UK GAAP, employer's taxes that are payable on the exercise of share options are provided for over the vesting period of the options. Under US GAAP such taxes are only accounted for when the options are exercised.

Deferred taxation Under UK GAAP, provision for deferred taxation is made only to the extent that liabilities are expected to crystallise in the foreseeable future. Under US GAAP, deferred taxation is recorded in respect of all temporary differences between the tax bases and book values of assets and liabilities which will result in taxable or tax deductible amounts in future years and are recognised only to the extent that it is more likely than not that they will be realised. As a consequence of this difference, shareholders' equity is increased in each period by the value of the deferred tax assets on temporary differences recognised under US GAAP and the deferred tax charge in each period differs by the movement in these asset balances.

Consolidated profit and loss account Under UK GAAP, gains and losses on disposal of fixed asset trade investments are shown after operating profit. Under US GAAP, gains and losses are reported in income from operations. Under UK GAAP, profit before tax is stated before minority interests. Under US GAAP, income before income tax is stated after minority interests.

Investment in own shares/treasury stock Under UK GAAP, the shares held by the group in the ESOP and the QUEST are included as "investment in own shares" within fixed asset investments. Under US GAAP, these shares are treated as treasury stock and are included within shareholders' equity, at original cost. Under UK GAAP, investment in own shares is held at the lower of cost and amounts receivable on exercise of options, where applicable, and market value.

29 Summary of significant differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) followed by the group and United States Generally Accepted Accounting Principles (US GAAP) continued

Marketable securities Under US GAAP, investments in available-for-sale securities are marked to market where the market value is readily determinable and gains and losses are recorded in other comprehensive income. Under UK GAAP the Company's accounting policy is to carry such investments at cost less any provisions for diminution in value.

Tax on US share options In the US the group is entitled to a tax deduction for the amount treated as compensation under US tax rules for employee share options, which have been exercised by US employees during the year. This amount is equivalent to the difference between the option exercise price and the fair market value of the shares at the date of exercise. Under UK GAAP the tax benefit arising from this deduction is included in the tax charge in the profit and loss account. Under US GAAP, the tax benefit is recorded as an increase in shareholders' funds.

Acquisitions Under US GAAP, payments to purchase intangible assets that are still in development are charged directly to the profit and loss account. Such payments are included within goodwill under UK GAAP, giving rise to a difference in goodwill recognised and the associated amortisation charge.

Consolidated statement of cash flows The consolidated statement of cash flows prepared under UK GAAP presents substantially the same information as that required under US GAAP. These presentations differ, however, with regard to classification of items within the statements and as regards the definition of the cash and cash equivalents.

Under UK GAAP, cash does not include short-term deposits and investments which cannot be withdrawn without notice and without incurring a penalty. Such items are shown as short-term investments. Under US GAAP, deposits with a maturity of less than three months at inception which are convertible into known amounts of cash are included as cash and cash equivalents. Under UK GAAP cash flows are presented separately for operating activities, returns on investments and servicing of finance, taxation, capital expenditure and financial investments, acquisitions and disposals, management of liquid resources and financing activities. US GAAP, however, requires only three categories of cash flow activity to be reported: operating, investing and financing. Cash flows from taxation and returns on investments and servicing of finance shown under UK GAAP are included as operating activities under US GAAP.

a) Reconciliation of UK GAAP operating profit to US GAAP income from operations

	2001	2000
	£000	£000
Group operating profit as reported under UK GAAP	**45,782**	31,156
Adjustments for:		
Movement in provision for employer's taxes on share options	**(9)**	219
Write-off of in-process research and development	**–**	(150)
Net gains on disposals of trade investments	**314**	–
Difference on amortisation of goodwill	**50**	12
Income from operations as reported under US GAAP	**46,137**	31,237

b) Reconciliation of UK GAAP profit before tax to US GAAP income before income tax

	2001	2000
	£000	£000
Profit before tax as reported under UK GAAP	**50,566**	35,495
Adjustments for:		
Movement in provision for employer's taxes on share options	**(9)**	219
Write-off of in-process research and development	**–**	(150)
Difference on amortisation of goodwill	**50**	12
Minority interest	**(303)**	(192)
Income before income tax as reported under US GAAP	**50,304**	35,384

c) Reconciliation of UK GAAP retained profit to US GAAP net income

	2001	2000
	£000	£000
Retained profit as reported under UK GAAP	**34,657**	30,271
Adjustments for:		
Movements in deferred tax assets	**(268)**	(975)
Movement in provision for employer's taxes on share options	**(9)**	219
Write-off of in-process research and development	**–**	(150)
Difference on amortisation of goodwill	**50**	12
Tax deduction for US employee share options	**(428)**	–
Net income as reported under US GAAP	**34,002**	29,377

29 Summary of significant differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) followed by the group and United States Generally Accepted Accounting Principles (US GAAP) continued

d) Reconciliation of shareholders' equity from UK to US GAAP

	2001 £000	2000 £000
Shareholders' funds as reported under UK GAAP	**137,527**	101,298
Adjustments for:		
Recognition of deferred tax assets on temporary timing differences	**584**	852
Investment in own shares/treasury stock	**(19,934)**	(35,544)
Contribution to QUEST, net of proceeds from allocation of shares	**17,546**	32,198
Provision for employer's taxes on share options	**210**	219
Revaluation of trade investment	**–**	2,087
Write-off of in-process research and development	**(150)**	(150)
Difference on amortisation of goodwill	**62**	12
Shareholders' equity as reported under US GAAP	**135,845**	100,972

e) Reconciliation of UK GAAP cash to US GAAP cash and cash equivalents

	2001 £000	2000 £000
Cash as reported under UK GAAP	**10,091**	5,783
Adjustment for short-term investments treated as cash equivalents under US GAAP	**94,376**	69,483
Cash and cash equivalents as reported under US GAAP	**104,467**	75,266

Selected consolidated financial data/US format

The following selected financial data should be read in conjunction with, and is qualified in its entirety by, reference to the financial statements of ARM Holdings plc, expressed in sterling, set forth on pages 56 to 71 of this report.

Selected consolidated financial data – US GAAP

	1997 £000	1998 £000	1999 £000	2000 £000	**2001** **£000**
Revenues	26,580	42,268	62,120	100,730	**146,274**
Cost of revenues	6,685	8,316	9,803	11,647	**17,289**
Operating expenses	15,807	26,361	36,530	57,846	**82,848**
Income from operations	4,088	7,591	15,787	31,237	**46,137**
Interest, net	484	1,911	2,266	3,912	**4,470**
Share of loss of equity affiliate	(31)	(71)	–	(85)	**–**
Gain on partial disposal of shares in equity affiliate	–	–	–	512	**–**
Minority interest	(15)	(8)	(64)	(192)	**(303)**
Income before income tax	4,526	9,423	17,989	35,384	**50,304**
Provision for income taxes	1,615	3,371	1,757	6,007	**16,302**
Net income	2,911	6,052	16,232	29,377	**34,002**

Earnings per common share (assuming dilution)	0.4p	0.4p	1.6p	2.9p	**3.3p**
IPO dividend per common share	–	0.5p	–	–	**–**
Research and development as a percentage of revenues	24.7%	30.1%	27.6%	26.2%	**25.3%**
Capital expenditure	£4,033	£6,402	£5,900	£11,842	**£17,349**
Cash and cash equivalents	£7,405	£39,591	£51,804	£75,266	**£104,467**
Shareholders' equity	£12,454	£48,280	£67,113	£100,972	**£135,845**
Total assets	£21,961	£60,580	£83,288	£127,343	**£175,814**
Employees at year end	274	354	443	619	**722**

Operating and financial review and prospects/US format

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto. The matters addressed in this operating and financial review and prospects, with the exception of the historical information presented, contain forward-looking statements involving risks and uncertainties.

Overview ARM designs high-performance, low-cost, power-efficient RISC microprocessors and related technology and software, and sells development systems, to electronics companies which, in turn, manufacture, market and sell microprocessors, application specific integrated circuits (ASICs) and application specific standard products (ASSPs) based on the ARM architecture to systems companies. ARM also licenses and sells development systems directly to systems companies and provides consulting and support services to its licensees, systems companies and other system designers. ARM has developed an innovative, intellectual property-centred and market-driven business model in which it neither manufactures nor sells the products incorporating ARM technology, but concentrates on the research and development, design and support of ARM architecture and supporting development tools and software.

The table below sets forth, for the periods indicated, the percentage of total revenues represented by certain items reflected in the Company's consolidated statements of income.

	Year ended December 31		
	1999	2000	**2001**
	%	%	**%**
Revenues:			
Product revenues	80.7	83.9	**87.5**
Service revenues	19.3	16.1	**12.5**
Total revenues	100.0	100.0	**100.0**
Cost of revenues:			
Product costs	7.4	4.6	**5.6**
Service costs	8.4	7.0	**6.2**
Total cost of revenues	15.8	11.6	**11.8**
Gross profit	84.2	88.4	**88.2**
Operating expenses:			
Research and development	27.6	26.2	**25.3**
Sales and marketing	18.6	17.7	**14.7**
General and administrative	12.4	12.2	**15.4**
Amortization of goodwill	0.2	1.3	**1.3**
Total operating expenses	58.8	57.4	**56.7**
Income from operations	25.4	31.0	**31.5**
Interest, net	3.6	3.9	**3.1**
Share of loss of equity affiliate	-	(0.1)	**-**
Gain on partial disposal of equity affiliate	-	0.5	**-**
Minority interest	(0.1)	(0.2)	**(0.2)**
Income before income tax	28.9	35.1	**34.4**
Provision for income taxes	2.8	6.0	**11.1**
Net income	26.1	29.1	**23.3**

Product revenues Product revenues consist of license fees, sales of development systems and royalties. Product revenues for 1999, 2000 and 2001 were £50.1 million, £84.6 million and £128.0 million, representing 81%, 84% and 87% of total revenues respectively.

License revenues as a percentage of total revenues decreased from approximately 54% in 1999 to approximately 45% in 2000 as royalties and development systems became a larger proportion of total revenues. With a slower growth in royalty revenues in 2001 when compared to 2000, this trend was slightly reversed with license revenues accounting for 52% of total revenues in 2001. The importance of the ARM7 family declined further in 2001, accounting for 45% of license revenues in 1999, 36% in 2000 and 20% in 2001. This continuing decline reflected the growing range of products available to license from the Company, including a broadening number of ARM9 and ARM10 core family products, architectural licenses which give licensees more rights to modify the technology, peripheral technology, models, sub systems and application software. Revenues from the ARM9 family have become increasingly important, accounting for 27% of revenue in 1999, 31% in 2000 and 44% in 2001. 27 new licensees were signed in 2001 bringing the total number of semiconductor partners to 77. Of these, 18 were "per use" licensees who joined the foundry programme, introduced in 2000 to enable small fabless chip companies to gain access to the Company's technology at a lower price point. Existing semiconductor partners licensed further cores in 2001 with 46 separate products licensed by 27 different partners during the year. Of these, 17 were for products from microprocessor core families not previously licensed, and 29 were for further cores within families already licensed. Sales of licenses to the existing customer base of semiconductor partners has become a more important part of the business, accounting for approximately 80% of total license fees in 2001; this compares to approximately 66% in 2000 and 50% in 1999. The sale of non-core licenses, covering items such as peripherals, embedded trace modules, models, and sub systems, increased in 2001 to £11.9 million from £7.8 million in 2000 and £6.5 million in 1999 representing approximately 15% of license revenues in 2001, 17% in 2000 and 20% in 1999.

Revenues from the sale of development systems increased from £5.6 million in 1999 to £13.6 million in 2000 and £23.3 million in 2001 representing approximately 9%, 14% and 16% of total revenues in 1999, 2000 and 2001 respectively. The increase in revenues reflected the growing number of products available to help engineers in designing products using the ARM architecture, an increasing level of design activity globally based around the ARM architecture and an improved third-party distribution network which has been established in the past two years. Strong customer demand for products has further improved revenues.

Royalties are either set as a percentage of the licensee's net sales price per chip or, less frequently, as a fixed amount and are recognized when the Company receives notification from the customer of product sales. In effect, this means that it is normally in the quarter following the shipments that data is received and so royalty data for a year reflects actual shipments made from October of the previous year to September of the current year inclusive. Royalties increased from £11.1 million in 1999 to £25.6 million in 2000 and £27.9 million in 2001 representing 18%, 25% and 19% of total revenues in 1999, 2000 and 2001 respectively. There was a significant increase in volume shipments from 131 million units in 1999 to 367 million units in 2000 mainly as a result of very rapid growth in the sale of cellular phones, which accounted for over 75% of products using the Company's technology. In 2001, cellular phone sales leveled off, but many other products began to ship in volume such as printers, digital cameras, smart cards, disc drives and networking products and unit shipments in 2001 grew to 420 million units. The Company expects royalty revenues to continue to grow although they may be subject to significant fluctuations. Unit shipments into the non-wireless markets have increased in 2001 and the Company expects this trend to continue into 2002.

Service revenues Service revenues consist of design consulting services and revenues from support, maintenance and training. Service revenues increased from £12.0 million in 1999 to £16.2 million in 2000 and £18.3 million in 2001 representing 19%, 16% and 13% of total revenues in 1999, 2000 and 2001 respectively. Consulting revenues increased from £6.5 million in 1999 to £8.2 million in 2000 but declined to £7.4 million in 2001 as engineering resource was directed away from consulting projects to higher-margin license generating activities. Revenues from support, maintenance and training increased from £5.5 million in 1999 to £8.0 million in 2000 and £10.9 million in 2001. The Company believes that important opportunities exist to improve revenues from support and training activities if overall service levels can be increased in the future.

Geographic analysis Operating in a global environment, the geographic destinations of the Company's revenues fluctuate from period to period depending upon the country of origin of its customers. The pattern of revenues in 2001 was 49% of revenues coming from the US, 23% from Japan, 9% from East Asia, excluding Japan, and 19% from Europe. This was a slight variation from 2000, when revenues from the US represented 55%, Japan 18%, East Asia, excluding Japan 7%, and Europe 20%. In 1999, 53% of revenues came from the US, 27% came from Japan, 7% from East Asia, excluding Japan, and 13% from Europe.

Product costs Product costs are limited to variable costs of production such as the costs of manufacture of development systems and costs incurred in making third-party operating systems compatible with the ARM architecture. Product costs were £4.6 million in 1999, £4.6 million in 2000 and £8.2 million in 2001 representing 7%, 5% and 6% of total revenues in 1999, 2000 and 2001 respectively. Approximately four-fifths of total product cost of sales were made up of development systems costs in 2000 and 2001 and the 78% increase between the two years is explained by a 71% growth in development systems sales with the balance comprising additional costs related to the costs of third-party operating systems. Product gross margin in 2001 fell slightly to 94%, compared to 95% in 2000 and 91% in 1999. The Company does not currently expect a significant increase in product costs in 2002, although this would be subject to significant fluctuations if management were obliged to port further operating systems to run on the ARM architecture.

Service costs Service costs include the costs of support and maintenance services to licensees of the technology as well as the costs directly attributable to consulting work performed for third parties. Cost of services increased from approximately £5.2 million in 1999, to £7.1 million in 2000, and £9.1 million in 2001. The service gross margin was approximately 57% in 1999, 56% in 2000, and 50% in 2001. Service margins declined in 2001 compared with 2000 and 1999 as less profitable consulting contracts were undertaken, while in an effort to continue to improve customer service levels, support costs were increased by 94%.

Research and development Research and development costs increased from £17.2 million in 1999 to £26.4 million in 2000, and £36.9 million in 2001 representing 28%, 26% and 25% of total revenues, respectively. Included in research and development costs for 1999 was a non-cash compensation expense of £284,000, relating to stock options granted between March 1997 and March 1998. There was no further compensation charge made in 2000 or 2001. Continued investment in research and development remains an essential part of the Company's strategy since its development of new products to license is key to its success. Current projects include next-generation microprocessor cores including additional versions of the ARM10 architecture, development of the ARMv6 architecture and its first implementation, as well as enhanced "sub system" system-on-chip solutions (platforms) and development tool offerings.

Total engineering headcount increased from 264 at the end of 1999, to 376 at the end of 2000, and 429 at the end of 2001. In addition, there were approximately 16 contractors in 1999, 15 in 2000 and 18 employed in 2001. Grant income receivable from the European Union, which is netted against research and development expenses, amounted to £0.2 million in 1999, and 2000 and £0.3 million in 2001. The absolute level of grant income is not expected to grow significantly over the next few years.

Sales and marketing Sales and marketing expenditure increased from £11.6 million in 1999, to £17.8 million in 2000, and £21.5 million in 2001, representing 19% of total revenues in 1999, 18% in 2000, and 15% in 2001. Included in sales and marketing costs for 1999 was a non-cash compensation expense of £268,000, relating to stock options granted between March 1997 and March 1998. There was no further compensation charge made in 2000 and 2001. Headcount in this area increased from 127 at the end of 1999, to 162 in 2000 and 198 in 2001. The total number of offices with sales people is currently 13 and this enables improved contact with the Company's geographically diverse customer base. New offices were opened in 2000 in Taiwan, Israel, France and the US. In 2001, a further sales office was opened in the US and plans were made to open an office in mainland China in 2002.

General and administrative General and administrative headcount increased from 52 at the end of 1999 to 81 at the end of 2000 and 95 in 2001. General and administrative costs rose from £7.7 million in 1999 to £12.3 million in 2000 and £22.5 million in 2001, representing 12%, 12% and 15% of total revenues, respectively. Included in general and administrative costs in 1999 were non-cash compensation expenses of £184,000 relating to stock options granted between March 1997 and March 1998. There was no further compensation charge made in 2000 and 2001. Costs in 2000 were increased by the commencement of legal action against picoTurbo, Inc. for infringement of patents as well as increased recruitment and professional fees in a year when over 170 staff were recruited. In 2001, legal costs increased to £5.5 million, human resources costs grew by £2 million with greater emphasis on employee training and establishment costs rose by £1 million with improved office accommodation. Provisions for doubtful debts of £0.7 million were also made, reflecting more difficult trading conditions for many of our smaller customers. There was a gain on foreign exchange of £0.3 million in 1999, an exchange gain of £0.1 million in 2000 and an exchange loss of £0.2 million in 2001. See "Foreign Currency Fluctuations" below. The litigation against picoTurbo, Inc. was concluded in December 2001 in an out of court settlement. Under the terms of the settlement, picoTurbo, Inc. assigned its intellectual property assets to the Company, acknowledged the validity and enforceability of the Company's patents and simultaneously agreed to cease all sales and marketing activities forthwith, for a payment of $11 million.

Amortization of goodwill and intangible assets Amortization of £0.1 million of goodwill was made in 1999 in relation to the acquisition of Micrologic Solutions Limited, a private company based in Cambridge, UK, which the Company purchased for £1.3 million in October 1999. Goodwill of approximately £1.1 million was amortized over a two-year period which commenced in November 1999. The Company purchased the assets of Infinite Designs Limited in March 2000, EuroMIPS Systems SAS in June 2000 and Allant Software Corporation in September 2000. In 2001, the Company purchased the assets of Noral Micrologics Limited, a ten-person company with expertise in debugging software, for a consideration of £1.4 million. This is being amortized over a period of three years. Amortization of goodwill of £1.9 million (2000: £1.3 million) was charged to the income statement in 2001. In process research and development costs of £0.2 million relating to the acquisition of Allant Software Corporation was written off in 2000.

During 2000 a license connected with the rights to use a certain debugging technology for use in the Company's development systems products was purchased for £2.8 million. This is being amortized over a period of three years with £0.9 million (2000: £0.2 million) amortized during 2001.

The Company also purchased a new license for £1.1 million in 2001 to enable the Company to produce and license Java™-related products.

Interest Interest grew from £2.3 million in 1999 to £3.9 million in 2000 and £4.5 million in 2001 reflecting the additional interest earned from the strong cash generation of the last three years. The growth in interest earned between 2000 and 2001 was much lower than the growth in cash balances, reflecting the drop in market interest rates during 2001. The Company invested cash balances over periods of up to three months during 2001.

Income before income tax Income before income tax grew from £18.0 million in 1999 to £35.4 million in 2000 and £50.3 million in 2001 representing 29%, 35% and 34% of total revenues respectively. The growth in overall margins between 1999 and 2000 was principally attributable to higher royalty revenues. The slight drop in margins in 2001 was partly due to lower returns on cash deposits.

Tax charge The Company's effective tax rates were 10% in 1999, 17% in 2000 and 32% in 2001. In 1999, tax rates dropped very significantly. The principal reason for this was the establishment of a Qualifying Employee Share Ownership Trust ("QUEST"), a trust set up to acquire new shares in the Company for the benefit of employees and directors of the group. The contribution by the Company to the QUEST for the purchase of 3,900,000 shares by the QUEST in November 1999 is a tax deductible expense under existing UK tax legislation. The Company made two further contributions to the QUEST in March 2000 and November 2000, when the QUEST purchased 1,483,440 shares and 559,559 shares respectively. These contributions were again the main reason for the low effective tax rate. The Company did not make further contributions to the QUEST in 2001 and so the tax rate returned to normal levels. Full details with respect to the QUEST are disclosed in footnote 1 of the Financial Statements.

Liquidity and capital resources The Company's operating activities provided net cash of £18.9 million, £42.7 million and £52.0 in 1999, 2000 and 2001 respectively. In 1999, the main impact on cash generated from operations was an increase in accounts receivable of £4.8 million and a reduction in income taxes payable of £2.6 million, largely as a result of the implementation of the QUEST. In 2000 the significant items impacting on cash generated from operations were the increase in accounts receivable of £4.7 million and the increase in deferred revenue of £5.1 million. In 2001, accounts receivable increased a further £6.6 million while deferred revenues grew by £6.7 million. The Company believes that, given its current level of business, it has sufficient working capital for the foreseeable future.

At December 31, 2001, the Company recorded approximately £19.4 million in deferred revenues (December 31, 2000: £12.7 million) which represented cash or receivables scheduled to be recognized in revenues in varying amounts after December 31, 2001.

Cash flow from operations has been used to fund the working capital requirements of the Company as well as capital expenditure. Capital expenditure in 2001 rose to £17.3 million from £11.8 million in 2000 and £5.9 million in 1999. The increasing expenditures in the last three years have been due to the need to invest in new design automation tools for a rapidly expanding workforce and the costs of establishing and improving the Company's design centres in the UK, France and the USA. In 2000 £4.7 million was spent on improvements to offices. Further investment was made in design tools in the UK and the US with £6.6 million being spent on computers and software. In 2001, £4.0 million was spent on office improvements with £13.4 million spent on computer equipment and software. As the Company has adequate cash resources, all of the capital expenditure items are purchased outright.

During 1996, the Company made two investments in small start-up companies, namely Sirius Communications NV and Palmchip Corporation ("Palmchip"). This amounted to £0.2 million in aggregate. In 1997, the Company made a further investment in Palmchip and converted its existing loan to give the Company a 45% shareholding. During 2000 the Company disposed of part of its share in Palmchip for £0.5 million with the result that it was no longer treated as an equity affiliate. The Company's share of the loss of Palmchip up to the disposal date was £0.1 million (1999: £nil).

During 1999, the Company purchased the entire share capital of Micrologic Solutions Limited, a 25-person applications software house, for a cost of £1.3 million. This company has subsequently been absorbed within the Company's software group.

During 2000, the Company purchased the entire share capital of EuroMIPS Systems SAS (now ARM France SAS) and Allant Software Corporation, and the trade and assets of Infinite Designs Limited. The aggregate sum paid for these three acquisitions amounted to £3.4 million.

In 2001, the Company purchased part of the business of Noral Micrologics Limited for £1.4 million cash.

The Company envisages making strategic investments in the future, in situations where the Company can broaden its product portfolio, where it can obtain skilled engineering resources and where the potential for furthering ARM core-based design wins is improved significantly.

During 2000, the Company made the following investments in available-for-sale securities: £1.3 million in Parthus Technologies plc, £0.7 million in Cambridge Silicon Radio Limited, and £2.1 million in CoWare, Inc. In 2001, the Company made the following investments in available-for-sale securities: £0.3 million in LinkUp Systems, Inc., and £1.0 million in Pixim, Inc. In addition, the Company sold its investment in Parthus for a profit of £0.1 million, and its investment in Sirius Communications NV for a profit of £0.5 million. It recognized a loss on its investment in LinkUp Systems of £0.3 million at the end of 2001 when LinkUp's entire business was purchased by a third party.

Cash balances at December 31 were £75.3 million in 2000, and £104.5 million in 2001. At December 31, 2000, accounts receivable were £18.9 million and £24.8 million at December 31, 2001, which represented 19% and 17% of revenues, respectively.

Foreign currency fluctuations The Company's earnings and liquidity are affected by fluctuations in foreign currency exchange rates, principally the US dollar rate, reflecting the fact that most of the Company's revenues and cash receipts are denominated in US dollars while a high proportion of its costs are in sterling.

The Company reduces this dollar/sterling risk where possible by currency hedging. Due to the high value and timing of receipts on individual licenses and the requirement to settle certain expenses in US dollars, the Company reviews its foreign exchange exposure on a transaction-by-transaction basis. It then hedges this exposure using forward contracts for the sale of US dollars, which are negotiated with major UK clearing banks. The average size of each forward contract was $2.5 million in 1999, $3.5 million in 2000, and $3.0 million in 2001. The Company does not currently use any other financial instruments or derivatives, although the Company is reviewing the use of other financial instruments such as currency options. The fair values of the financial instruments outstanding at the end of December 31, 1999, 2000 and 2001 are disclosed in footnote 12 to the financial statements. The settlement period of the forward contracts outstanding at December 31, 2001 is between January 1 and April 30, 2002.

Risk factors The Company operates in the intensely competitive semiconductor industry which is being characterized by price erosion, rapid technological change, short product life cycles, cyclical market patterns and heightened foreign and domestic competition. The Company believes that its future operating results will continue to be subject to quarterly variations based upon a wide variety of factors. These include the timing of entering into agreements with new licensees, the mixture of license fees, royalties and fees from services, and the introduction of new technology by the Company, the timing of orders from, and shipments to, systems companies of ARM core-based microprocessors from the Company's semiconductor Partners and sudden technological change in the microprocessor industry.

Other risks include the reliance on semiconductor Partners, dependence upon systems companies, patent protection, attraction and retention of employees, management of growth, competition and vulnerability to general economic conditions. Risk factors are more fully discussed in the Company's annual report on Form 20-F for 2001.

Consolidated statements of income and comprehensive income/US format

	1999 £000	2000 £000	**2001** **£000**	**2001*** **$000**
Revenues:				
Product revenues	50,141	84,562	**127,976**	**186,205**
Service revenues	11,979	16,168	**18,298**	**26,624**
Total revenues	62,120	100,730	**146,274**	**212,829**
Cost of revenues:				
Product costs	4,613	4,566	**8,209**	**11,944**
Service costs	5,190	7,081	**9,080**	**13,212**
Total cost of revenues	9,803	11,647	**17,289**	**25,156**
Gross profit	52,317	89,083	**128,985**	**187,673**
Operating expenses:				
Research and development	17,151	26,359	**36,941**	**53,749**
Sales and marketing	11,565	17,841	**21,457**	**31,220**
General and administrative	7,715	12,349	**22,521**	**32,768**
Amortization of goodwill	99	1,297	**1,929**	**2,807**
Total operating expenses	36,530	57,846	**82,848**	**120,544**
Income from operations	15,787	31,237	**46,137**	**67,129**
Interest, net	2,266	3,912	**4,470**	**6,504**
Share of loss of equity affiliate	–	(85)	**–**	**–**
Gain on partial disposal of equity affiliate	–	512	**–**	**–**
Minority interest	(64)	(192)	**(303)**	**(441)**
Income before income tax	17,989	35,384	**50,304**	**73,192**
Provision for income taxes	1,757	6,007	**16,302**	**23,719**
Net income	16,232	29,377	**34,002**	**49,473**
Net income	16,232	29,377	**34,002**	**49,473**
Other comprehensive income:				
Foreign currency adjustments	164	75	**14**	**20**
Unrealised holding gain/(loss) on available-for-sale securities	–	2,087	**(2,087)**	**(3,037)**
Total comprehensive income	16,396	31,539	**31,929**	**46,456**
Basic earnings per common share	1.7p**	3.0p	**3.4p**	**4.9c**
Earnings per common share (assuming dilution)	1.6p**	2.9p	**3.3p**	**4.8c**

* US dollar amounts have been translated from sterling at the December 31, 2001 closing rate of £1.00 = $1.455.

** Adjusted to reflect the five-for-one subdivision of the Company's shares in April 2000 where applicable.

All activities relate to continuing operations.

The accompanying notes are an integral part of the financial statements.

Consolidated balance sheets/US format

	2000 £000	**2001 £000**	**2001* $000**
Assets			
Current assets:			
Cash and cash equivalents	75,266	**104,467**	**152,000**
Accounts receivable, net of allowances for doubtful debts of £800,000 (2000: £155,000)	18,913	**24,809**	**36,097**
Inventory: finished goods	385	**581**	**845**
Prepaid expenses and other assets	4,652	**6,006**	**8,739**
Income taxes receivable	439	**550**	**800**
Total current assets	99,655	**136,413**	**198,481**
Deferred income taxes	740	**839**	**1,221**
Property and equipment, net	14,874	**22,668**	**32,982**
Intangible assets	5,440	**12,339**	**17,953**
Investments	6,634	**3,555**	**5,172**
Total assets	127,343	**175,814**	**255,809**
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	2,049	**2,361**	**3,435**
Income taxes payable	1,621	**7,054**	**10,264**
Personnel taxes	590	**784**	**1,141**
Accrued liabilities	9,128	**9,741**	**14,173**
Deferred revenue	12,677	**19,420**	**28,255**
Total liabilities	26,065	**39,360**	**57,268**
Minority interest	306	**609**	**886**
	26,371	**39,969**	**58,154**
Shareholders' equity			
Ordinary shares: £0.0005 par value; 1,580,000,000 authorized (2000: 1,580,000,000); 1,014,767,176 issued (2000: 1,000,235,371)	500	**507**	**738**
Additional paid-in capital	78,035	**65,362**	**95,102**
Treasury stock, at cost: 7,017,599 ordinary shares (2000: 10,942,999)	(35,544)	**(19,934)**	**(29,004)**
Retained earnings	55,764	**89,766**	**130,610**
Other comprehensive income:			
Unrealized holding gain on available-for-sale securities	2,087	**–**	**–**
Cumulative translation adjustment	130	**144**	**209**
Total shareholders' equity	100,972	**135,845**	**197,655**
Total liabilities and shareholders' equity	127,343	**175,814**	**255,809**

* US dollar amounts have been translated from sterling at the December 31, 2001 closing rate of £1.00 = $1.455.

The accompanying notes are an integral part of the financial statements.

Consolidated statements of cash flows/US format

	1999 £000	2000 £000	**2001 £000**	**2001* $000**
Cash flows from operating activities				
Net income	16,232	29,377	**34,002**	**49,473**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of tangible and intangible assets	4,714	7,777	**12,347**	**17,965**
Write-off of in-process research and development	–	150	**–**	**–**
Stock option compensation	736	–	**–**	**–**
Share of loss of equity affiliates	–	85	**–**	**–**
Deferred income taxes	386	560	**787**	**1,145**
Gain on partial disposal of equity affiliate	–	(512)	**–**	**–**
Provision for doubtful accounts	384	(248)	**673**	**979**
Other	60	262	**449**	**653**
Changes in operating assets and liabilities:				
Accounts receivable	(4,817)	(4,747)	**(6,569)**	**(9,558)**
Accounts receivable converted to trade investments	–	–	**(1,361)**	**(1,980)**
Inventory	23	(184)	**(196)**	**(285)**
Prepaid expenses and other current assets	(536)	(996)	**(1,354)**	**(1,970)**
Accounts payable	164	957	**312**	**454**
Income taxes payable	(2,605)	2,519	**5,322**	**7,744**
Deferred revenue	3,092	5,149	**6,743**	**9,811**
Accrued liabilities and other creditors	1,094	2,513	**613**	**892**
Personnel taxes	(59)	77	**194**	**282**
Net cash provided by operating activities	18,868	42,739	**51,962**	**75,605**
Cash flows from investing activities:				
Receipt from partial disposal of equity affiliate	–	517	**–**	**–**
Purchase of equipment	(3,624)	(7,182)	**(13,377)**	**(19,464)**
Purchase of leasehold improvements	(2,276)	(4,660)	**(3,972)**	**(5,779)**
Sale of equipment	20	59	**71**	**103**
Purchase of patent and licenses	–	(2,822)	**(8,568)**	**(12,466)**
Purchase of investments	–	(4,088)	**–**	**–**
Sale of investments	–	–	**1,936**	**2,817**
Purchase of subsidiaries and businesses, net of cash acquired	(1,187)	(3,414)	**(1,351)**	**(1,966)**
Net cash used in investing activities	(7,067)	(21,590)	**(25,261)**	**(36,755)**
Cash flows from financing activities				
Cash received on issue of shares on exercise of share options	287	2,320	**1,558**	**2,267**
Proceeds received on allocation of treasury stock	–	–	**958**	**1,394**
Net cash provided by financing activities	287	2,320	**2,516**	**3,661**
Effect of foreign exchange on cash and cash equivalents	125	(7)	**(16)**	**(23)**
Net increase in cash and cash equivalents	12,213	23,462	**29,201**	**42,488**
Cash and cash equivalents at beginning of the period	39,591	51,804	**75,266**	**109,512**
Cash and cash equivalents at end of the period	51,804	75,266	**104,467**	**152,000**
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	4,639	2,928	**9,643**	**14,031**
Cash received on interest	2,293	3,775	**4,604**	**6,699**

* US dollar amounts have been translated from sterling at the December 31, 2001 closing rate of £1.00 = $1.455.

The accompanying notes are an integral part of the financial statements.

Consolidated statements of changes in shareholders' equity/US format

	Ordinary shares		Additional paid-in capital	Cumulative translation adjustment	Treasury stock	Unrecognized holding gain	Retained earnings*	Total
	Number**	Amount £000	£000	£000	£000	£000	£000	£000
Balances, January 1, 1999	944,272,580	472	39,200	(109)	(1,438)	–	10,155	48,280
Issue of ordinary shares	3,900,000	2	15,368					15,370
Share issue on exercise of options	11,681,445	6	281					287
Net income							16,232	16,232
Stock option compensation			736					736
Tax effect of stock purchase plan			1,414					1,414
Currency translation adjustment				164				164
Investment in treasury stock					(15,370)			(15,370)
Balances, December 31, 1999	959,854,025	480	56,999	55	(16,808)	–	26,387	67,113
Issue of ordinary shares	2,042,999	1	18,735					18,736
Share issue on exercise of options	38,338,347	19	2,301					2,320
Net income							29,377	29,377
Unrealized holding gains on available-for-sale securities						2,087		2,087
Currency translation adjustment				75				75
Investment in treasury stock					(18,736)			(18,736)
Balances, December 31, 2000	1,000,235,371	500	78,035	130	(35,544)	2,087	55,764	100,972
Share issue on exercise of options	14,531,805	7	1,551					1,558
Net income							34,002	34,002
Realization of holding loss on available-for-sale securities						(2,087)		(2,087)
Tax effect of stock purchase plan			428					428
Currency translation adjustment				14				14
Allocation of treasury stock			(14,652)		15,610			958
Balances, December 31, 2001	**1,014,767,176**	**507**	**65,362**	**144**	**(19,934)**	**–**	**89,766**	**135,845**

* The amount of shareholders' equity available for distribution to shareholders is the amount of profits determined under UK GAAP in the statutory accounts of the parent company. At December 31, 2001 such distributable profits amounted to £3,552,000.

** The number of shares and the dividend per share have been adjusted, where applicable, to reflect the four-for-one share subdivision which took place in April 1999 and the five-for-one share subdivision which took place in April 2000.

The accompanying notes are an integral part of the financial statements.

1 The Company and a summary of its significant accounting policies

The business of the Company ARM Holdings plc and its subsidiary companies design RISC microprocessors and related technology and software, and sell development systems, to enhance the performance, cost-effectiveness and power-efficiency of high-volume embedded applications. The group licenses and sells its technology and products to leading international electronics companies, which in turn manufacture, market and sell microprocessors, ASICs and ASSPs based on the group's architecture to systems companies for incorporation into a wide variety of end products. By creating a network of partners, and working with them to best utilize the group's technology, the group is establishing its architecture as a RISC processor for use in many high-volume embedded microprocessor applications, including digital cellular phones, modems and automotive functions and for potential use in many growing markets including smart cards and digital video. The group also licenses and sells development systems directly to systems companies and provides consulting and support services to its licensees, systems companies and other systems designers. The group's principal geographic markets are Europe, the United States, Japan and South Korea.

Incorporation and history ARM is a public limited company incorporated under the laws of England and Wales. The Company was formed on October 16, 1990 as a joint venture between Apple Computer (UK) Limited and Acorn Computers Limited and operated under the name Advanced RISC Machines Holdings Limited until March 10, 1998 when its name was changed to ARM Holdings plc. Its initial public offering was on April 17, 1998.

Group undertakings include ARM Limited (incorporated in the United Kingdom), ARM, INC. (incorporated in the United States), ARM KK (incorporated in Japan), ARM Korea Limited (incorporated in South Korea), ARM France SAS (incorporated in France), Allant Software Corporation (incorporated in the US), Advanced RISC Machines Limited (incorporated in the UK), Micrologic Solutions Limited (incorporated in the UK) and ARM Taiwan Limited (incorporated in Taiwan).

Basis of preparation The accompanying consolidated financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in the US (US GAAP).

Purely for the convenience of the reader, the December 31, 2001, consolidated financial statements have been translated from sterling at the closing rate on December 31, 2001, of £1.00 = $1.455. Such translations should not be construed as representations that sterling could be so converted into US dollars at that rate or at any other rate.

Principles of consolidation The consolidated financial statements incorporate the financial statements of the Company and all its subsidiaries. Intra-group transactions, including sales, profits, receivables and payables, have been eliminated on consolidation.

Equity affiliates Companies in which the group owns between 20% and 50% of the voting stock are treated as equity affiliates. During 2000, the group made a partial disposal of its holding in Palmchip Corporation with the result that the remaining holding is below 20% and is therefore treated as an available-for-sale security. The consolidated statements of income include the group's share of net income of equity affiliates up to the date of the partial disposal. The remaining investment is included in the consolidated balance sheet at the value of the group's share of net assets at the date of disposal. The group had no equity affiliates at December 31, 2000, or at December 31, 2001.

Investments Investments are classed as available for sale in accordance with Statement of Financial Accounting Standards (SFAS) No.115, "Accounting for certain investments in debt and securities" and are carried at fair value. Unrealized holding gains or losses on such securities are included, net of related taxes, in other comprehensive income in shareholders' equity. Realized gains and losses of such securities are reported in earnings. Equity securities that are not publicly traded are recorded at cost less permanent diminution in value; at December 2001 and 2000, the estimated fair value of these investments approximated their recorded basis, based on publicly available market information or other estimates determined by management. The group invested in two unlisted companies during 2000, one of which was a 3.5% investment in the share capital of CoWare, Inc., a company which develops system-on-chip software for a wide range of applications, and the other was a less than 1% investment in the share capital of Cambridge Silicon Radio Limited, an intellectual property company which develops Bluetooth™ solutions. Two further trade investments were made in 2001, one of which was a 1.7% investment in Pixim, Inc., and the other was a 1.3% investment in LinkUp Systems, Inc. Both of these are fabless chip companies based in California. Investments are included in the consolidated balance sheet at cost (as an approximation to market value). Equity shares in both companies were received in settlement of accounts receivable. All investments are held by ARM Limited.

The group sold its 3% stake in Sirius Communications NV during the year.

The group made an investment in Parthus Technologies plc during 2000. This company, although unlisted at the time of investment, subsequently floated on the London Stock Exchange, and was included in the 2000 consolidated balance sheet at market value at the balance sheet date. This investment was disposed of in its entirety in 2001.

Goodwill and intangible assets Purchased goodwill, patents and licenses to use technology are capitalized and amortized on a straight-line basis over a prudent estimate of the time that the Company is expected to benefit from them. An independent valuation is made of any in-process research and development on acquisition and the amount written off immediately. One such project was acquired during the year to December 31, 2000, and was independently valued at £150,000. Due to the immaterial nature of this project no further disclosures have been given in respect of the nature, completion or risks of the project, or of subsequent developments in relation to the project.

Revenue recognition Revenue consists of license fees received under the terms of license agreements with customers to enable them to use the group's IP which is customized to each customer's manufacturing process. The group licenses its IP to leading electronics companies which in turn manufacture, market and sell microprocessors, ASICs and ASSPs based on the group's architecture to systems companies for incorporation into a wide variety of end products. The group's IP consists of software and related documentation which enables a customer to design and manufacture microprocessors and related technology and software. Each license is designed to meet the specific requirements of each customer and is generally not time limited in its application. In general, the time between the signing of a license and final customer acceptance is between nine and 15 months with most

1 The Company and a summary of its significant accounting policies continued

time allocated to the period between delivery and acceptance of the technology. Delivery generally occurs within a short time period after signing. The customer obtains license rights to the IP at the time of signing. In addition, the customer obtains ownership of the licensed rights to the in-process customization as well as the completed customization. License fees are invoiced according to an agreed set of milestone payments. Typically the first milestone is on signing of the contract, the second is on delivery of the customized IP (being the IP and other technical information relating to the product licensed) and the third is related to acceptance of the technology by the licensee. No upgrades or modifications to the licensed IP are provided. Following customer acceptance, the group has no further obligations under the license agreement.

In accordance with SOP 97-2 "Software revenue recognition", where agreements involve multiple elements, the entire fee from such arrangements has been allocated to each of the individual elements based on each element's fair value. Vendor specific objective evidence (VSOE) of fair value is determined from license agreements with other customers where elements are sold separately.

In accordance with SOP 81-1 "Accounting for performance of construction-type and certain production type contracts", as license agreements include deliverables that require "significant production, modification or customization", contract accounting is applied. Revenues from license fees are recognized based on the percentage-to-completion method over the period from signing of the license to customer acceptance and the completion of all outstanding obligations. The amount of revenue recognized is based on the total license fees under the license agreement and the percentage to completion achieved. The percentage to completion is measured by monitoring progress using records of actual time incurred to date in the project, compared with the total estimated project requirement, which corresponds to the costs of earned revenues. Revenues are only recognized when collectability is probable.

Estimates of total project requirement are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management. Under the percentage-to-completion method, provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of such losses is determined.

Agreements including rights to unspecified products are accounted for using subscription accounting, revenue from the arrangement being recognized over the term of the arrangement, or an estimate of the economic life of the products offered, beginning with the delivery of the first product.

In addition to the license fees, contracts generally contain an agreement to provide post contract support (support, maintenance and training) which consists of an identified customer contact at the group and telephonic or e-mail support. Fees for post contract support which take place after customer acceptance are specified in the contract. The fees are determined based on the group's price list as if sold separately. The price list is established and regularly reviewed by management. Revenue for post contract support is recognized on a straight-line basis over the period for which support and maintenance is contractually agreed by the group with the licensee.

Sales of software, including development systems, which are not specifically designed for a given license (such as off-the-shelf software) are recognized upon delivery. At that time, the group has no further obligations except that, where necessary, the costs associated with providing post contract support have been accrued. Services (such as training) that the group provides which are not essential to the functionality of the IP are separately stated and priced in the contract and, therefore, accounted for separately. Revenue is recognized as services are performed and collectability is probable.

The excess of license fees invoiced over revenue recognized in respect of such fees is recorded as a deferred revenue liability.

Royalty revenues are earned on sales by the group's customers of products containing ARM technology. Revenues are recognized when ARM receives notification from the customer of product sales, or receives payment of any fixed royalties, normally quarterly in arrears.

Revenue from consulting is recognized when the service has been provided and all obligations to the customer under the consulting agreement have been fulfilled. For larger consulting projects containing several project milestones, revenue is recognized on a percentage-to-completion basis as milestones are achieved. Consulting costs are recognized when incurred.

Research and development All ongoing research and development expenditure is expensed in the period in which it is incurred.

Grants Grants in respect of specific research and development projects are receivable from the European Commission, a European organization which funds certain research and development activities on application to it for the purposes of furthering research and development activities within the European Union. The group retains significant rights to intellectual property developed under projects which are funded under these arrangements. Grants received are intended to cover 50% of expected project costs. Grant income is recognized over the period of the project in line with the costs incurred. Unconditional undertakings have been received from the European Commission to provide the funding, and there is no obligation to refund any amounts already received. Amounts receivable under these arrangements in the year ended December 31, 2001 were £268,000 (2000: £186,000; 1999: £248,000) and were netted against related research and development costs.

Pension costs The group contributes to defined contribution plans substantially covering all employees in Europe and the US and to government pension schemes for employees in Japan, South Korea, Taiwan and Israel. The group contributes to these plans based upon various fixed percentages of employee compensation and such contributions are expensed as incurred. The amount of contributions expensed by the group for the years ended December 31, 1999, 2000, and 2001, were £853,000, £1,160,000, and £1,591,000 respectively.

Cash equivalents The group considers all highly liquid investments with original maturity dates of three months or less to be cash equivalents.

Inventory Inventory is stated at the lower of cost and net realizable value. In general, cost is determined on a first-in-first-out basis and includes transport and handling costs. Where necessary, provision is made for obsolete, slow-moving and defective inventory.

Property and equipment The cost of property and equipment is their purchase cost, together with any incidental costs of acquisition.

1 The Company and a summary of its significant accounting policies continued

Depreciation is calculated so as to write off the cost of property and equipment, less their estimated residual values, on a straight-line basis over the expected useful economic lives of the assets concerned. The principal economic lives used for this purpose are:

Freehold buildings	25 years
Leasehold improvements	Five years or term of lease, whichever is shorter
Computers and software	Three years
Fixtures and fittings	Five to ten years
Motor vehicles	Four years

Provision is made against the carrying value of tangible fixed assets where an impairment in value is deemed to have occurred.

Operating leases Costs in respect of operating leases are charged on a straight-line basis over the lease term.

Currency translation The functional currency for the group's operations is the local currency in which it operates.

The assets and liabilities of subsidiaries denominated in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date.

Statements of income of overseas subsidiaries are translated at the average exchange rate for the period. Translation differences are taken to the cumulative translation adjustment.

The group utilizes forward exchange contracts to manage the exchange risk on actual transactions related to accounts receivable, denominated in a currency other than the functional currency of the business. The group's forward exchange contracts do not subject the group to risk from exchange rate movements because the gains and losses on such contracts offset losses and gains, respectively, on the transactions being hedged. Because the group does not meet the criteria for hedge accounting, the forward contracts and the related accounts receivable are recorded at fair value at each period end. All recognized gains and losses resulting from the settlement of the contracts are recorded within general and administrative costs in the income statement. The group does not enter into foreign exchange contracts for the purpose of hedging anticipated transactions.

Other transactions denominated in foreign currencies have been translated into sterling at actual rates of exchange ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies have been translated at rates ruling at the balance sheet date. Exchange differences have been included in general and administrative costs.

Income taxes Income taxes are computed using the liability method. Under this method, deferred income tax assets and liabilities are determined based on temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established against deferred tax assets where it is more likely than not that some portion or all of the asset will not be realized.

Earnings per share Basic earnings per common share is computed based on the weighted average number of ordinary shares. Earnings per common share (assuming dilution) is computed by including potential common shares where the effect of their inclusion would be dilutive. The diluted share base for the 12 months ended December 31, 2001, excludes incremental shares of approximately 6,257,831 (2000: 274,000; 1999: nil) related to employee stock options. These shares are excluded due to their antidilutive effect as a result of the exercise price of these shares being higher than the market price. The ordinary equivalent shares for share options were determined using the treasury stock method.

Accounting for stock-based compensation The group has elected to use the intrinsic value-based method to account for all of its employee stock-based compensation plans. Under APB Opinion No. 25, "Accounting for stock issued to employees", compensation cost has been recognized for stock options granted in the year ended December 31, 1997, and in March 1998, because the exercise price of the options was less than the fair value of the underlying stock as of the grant date for each stock option. The group has adopted the disclosure requirements of SFAS 123, "Accounting for stock-based compensation". Apart from options issued to certain executive directors, there are no performance conditions attached to the exercise of options. For executive directors, discretionary share options of up to two times base salary may be issued each year that will vest after seven years. If, however, the Company achieves EPS growth of 33.1% above the rate of inflation over a period of three years, then all the options are exercisable after three years.

Employee share ownership plans Treasury stock represents the cost of shares in the Company held by the Employee Benefit Trust (ESOP) and the Qualifying Employee Share Ownership Trust (QUEST).

The ESOP was set up on April 16, 1998, to facilitate the recruitment, retention and motivation of employees. No options had been granted over these shares and no shares had been allocated at December 31, 2001. The market value of unearned shares at December 31, 2001, was approximately £17,950,000. All costs relating to the schemes are recognized in the income statement as they accrue and the ESOP has waived the right to receive dividends of over and above 0.01 pence per share on all shares held. For the purpose of earnings per share calculations, the shares are treated as canceled until such time as they vest unconditionally.

Treasury stock held also includes £950,000 relating to 2,017,599 shares held by the group's QUEST, which was established by the Company during 1999. The Company established the QUEST to acquire new shares in the Company for the benefit of employees and directors of the group. No shares were purchased in 2001. In 2000 and 1999, 2,042,999 and 3,900,000 shares, respectively, were purchased as detailed on the following page.

1 The Company and a summary of its significant accounting policies continued

On March 13, 2000, and November 7, 2000, the Company provided £14,445,000 and £4,291,000 respectively (1999: £15,370,000) for this purpose of which £14,018,000 and £3,769,000 respectively, being £17,787,000 in total, (1999: £14,411,000) was by way of a gift, and £427,000 and £522,000 respectively, being £949,000 in total, (1999: £959,000) was by way of a loan. On the same dates, the QUEST subscribed at market value for 1,483,440 and 559,559 respectively (1999: 3,900,000) of the Company's 0.05 pence ordinary shares. The shares rank pari passu in all respects with the existing ordinary shares. They will be allocated to employees and directors to satisfy their options granted under the Company's Save As You Earn Option Schemes.

The cost of all the shares has been treated as treasury stock. The excess of the subscription price over the nominal value, which amounts to £34,104,499, has been taken to additional paid-in capital. For the purpose of earnings per share calculations, the shares are treated as canceled until such time as they vest unconditionally.

During 2001, 3,925,400 shares were allocated from the QUEST following the exercise of share options granted under the group's Save As You Earn scheme.

Under the terms of the trust deed, dividends have been waived on the shares held by the QUEST, and all costs relating to the scheme are dealt with in the income statement as they accrue.

Employer's taxes on share options Employer's National Insurance in the UK and equivalent taxes in other jurisdictions are payable on the exercise of certain share options issued to employees in certain tax jurisdictions. In accordance with EITF 00-16 no provision has been made for the employer's taxes on these share options. These amounts will be recognized in the consolidated income statement when payable.

Use of estimates The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Recently issued accounting standards In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business combinations" (SFAS 141) which supersedes APB Opinion No. 16, "Business combinations", and SFAS No. 38, "Accounting for pre-acquisition contingencies of purchased enterprises". SFAS 141 addresses financial accounting and reporting for business combinations and requires that all business combinations within scope of SFAS 141 be accounted for using only the purchase method. SFAS 141 is required to be adopted for all business combinations initiated after June 30, 2001. Management has assessed the impact of the adoption of SFAS 141 on its consolidated financial statements and believes the impact will not be material.

Also in July 2001, the FASB issued SFAS No. 142, "Goodwill and other intangible assets" (SFAS 142) which supercedes APB Opinion No. 17, "Intangible assets". SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. SFAS 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. The provisions of SFAS 142 are required to be applied starting with fiscal years beginning after December 15, 2001. SFAS 142 is required to be applied at the beginning of an entity's fiscal year and to be applied to all goodwill and other intangible assets recognized in its financial statements at that date. Management is currently evaluating the impact that adoption of SFAS 142 will have on its consolidated financial statements.

In October 2001, the FASB issued SFAS 144, "Accounting for the impairment or disposal of long-lived assets" (SFAS 144) which supercedes SFAS 121, "Accounting for the impairment of long-lived assets and for long-lived assets to be disposed of", and the accounting and reporting provisions of ABP 30, "Reporting the results of operations – reporting the effects of disposal of a segment of a business, and extraordinary, unusual and infrequently occurring events and transactions". SFAS 144 retains the fundamental provisions of SFAS 121 for the recognition and measurement of the impairment for long-lived assets and the measurement of long-lived assets to be disposed of by sale. Its issuance is to address the significant issues relating to the implementation of SFAS 121 and to develop a single accounting model, based on the framework established in SFAS 121, for long-lived assets. Generally, the provisions of SFAS 144 are effective for fiscal years beginning after December 15, 2001, with the initial application as of the beginning of the fiscal year. Management has yet to assess the impact that the adoption of SFAS 144 will have on its consolidated financial statements.

Companies Act 1985 These financial statements do not comprise statutory accounts within the meaning of Section 240 of the Companies Act 1985 of Great Britain (the "Companies Act"). The Company's statutory accounts, which are its primary financial statements, are prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP) in compliance with the Companies Act and are presented in pounds sterling. Statutory accounts (upon which the auditors gave unqualified reports under Section 235 of the Companies Act which did not contain statements under sub-sections 237(2) and (3) of the Companies Act) for the years ended December 31, 1999 and 2000 have been, and those for the year ended December 31, 2001, will be delivered to the Registrar of Companies for England and Wales. Dividends are required to be declared in sterling out of profits available for that purpose as determined in accordance with UK GAAP and the Companies Act.

2 Related party transactions

Until the partial disposal of Palmchip Corporation in 2000 the directors regarded the company as a related party by virtue of its being an associated undertaking; in 2000, prior to the partial disposal, Palmchip repaid a loan of £248,000 previously made to it by ARM Limited.

3 Income taxes

Income before income tax is analyzed as follows:

	Year ended December 31		
	1999 £000	2000 £000	**2001 £000**
United Kingdom	16,100	32,568	**46,394**
Foreign	1,889	2,816	**3,910**
	17,989	35,384	**50,304**

The provision for income taxes consisted of:

	Year ended December 31		
	1999 £000	2000 £000	2001 **£000**
Current:			
United Kingdom	1,228	4,968	**14,502**
Foreign	1,639	479	**1,441**
Total current	2,867	5,447	**15,943**
Deferred:			
United Kingdom	(230)	72	**268**
Foreign	(880)	488	**91**
Total deferred	(1,110)	560	**359**
Total provision for income taxes	1,757	6,007	**16,302**

Included in the provision for income taxes is a current tax charge of £428,000 (2000: £nil; 1999: £1,163,000) and a deferred tax charge of £146,000 (2000: £617,000; 1999: credit of £880,000) in relation to employee stock options. Such benefits are reflected as additional paid-in capital.

The taxation charge in 2000 was reduced by £5,331,000 (1999: £4,359,000) following a payment of £17,787,000 (1999: £14,411,000) to the QUEST detailed in footnote 1. There were no payments to the QUEST in 2001.

Total income tax expense differs from the amounts computed by applying the UK statutory income tax rate of 30% for 2001, 2000 and 1999 to income before income tax as a result of the following:

	Year ended December 31		
	1999 £000	2000 £000	**2001 £000**
UK statutory rate 30% (2000: 30%, 1999: 30%)	5,442	10,615	**15,091**
Permanent differences arising on payment to QUEST	(4,359)	(5,331)	**–**
Permanent differences – other*	551	690	**1,150**
Differences in statutory rates of foreign countries	144	53	**99**
Other, net	(21)	(20)	**(38)**
	1,757	6,007	**16,302**

* Permanent differences comprise permanent adjustments, non-deductible stock option compensation and tax sparing.

3 Income taxes continued

Significant components of the deferred tax assets are as follows:

	Year ended December 31		
	1999	2000	**2001**
	£000	£000	**£000**
Fixed asset temporary differences	924	852	**584**
Temporary difference on available-for-sale securities	–	(458)	**–**
Non-deductible accruals and reserves	(46)	346	**255**
Losses carried forward	880	1,710	**1,397**
Total deferred tax assets	1,758	2,450	**2,236**
Valuation allowance	–	(1,710)	**(1,397)**
Net deferred tax assets	1,758	740	**839**

UK income taxes have not been provided at December 31, 2001 on unremitted earnings of approximately £7,401,000 (2000: £4,641,000; 1999: £2,700,000) of subsidiaries located outside the UK as such earnings are considered to be permanently invested. If these earnings were to be remitted without offsetting tax credits in the UK withholding taxes would be approximately £385,000 (2000: £232,000; 1999: £155,000).

The valuation allowance relates to net operating loss carryforwards of certain subsidiaries, where management believe it is more likely than not such amounts will not be realized.

4 Earnings per share

	For the year ended December 31, 1999		
	Income £	Shares number*	Per share amount*
Net income	16,232,000		
Basic EPS:			
Income available to common stockholders	16,232,000	945,322,165	1.7p
Effect of dilutive securities:			
Stock options		74,062,990	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	16,232,000	1,019,385,155	1.6p

* The number of shares and the per share amount have been adjusted, where applicable, to reflect the four-for-one subdivision which took place in April 1999 and the five-for-one subdivision which took place in April 2000.

	For the year ended December 31, 2000		
	Income £	Shares number	Per share amount
Net income	29,377,000		
Basic EPS:			
Income available to common stockholders	29,377,000	970,947,067	3.0p
Effect of dilutive securities:			
Stock options		57,329,109	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	29,377,000	1,028,276,176	2.9p

	For the year ended December 31, 2001		
	Income £	**Shares number**	**Per share amount**
Net income	**34,002,000**		
Basic EPS:			
Income available to common stockholders	**34,002,000**	**999,741,581**	**3.4p**
Effect of dilutive securities:			
Stock options		**24,891,393**	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	**34,002,000**	**1,024,632,974**	**3.3p**

5 Business risks and credit concentration

The group operates in the intensely competitive semiconductor industry which has been characterized by price erosion, rapid technological change, short product life cycles, cyclical market patterns and heightened foreign and domestic competition. Significant technological changes in the industry could affect operating results.

Financial instruments that potentially subject the group to concentrations of credit risk comprise principally cash and cash equivalents and accounts receivable. The group generally does not require collateral on accounts receivable, as the majority of the group's customers are large, well-established companies. The group has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

The group markets and sells to a relatively small number of customers with individually large value transactions. For further information see footnote 11. At December 31, 2001 no customers accounted for more than 10% of accounts receivable. At December 31, 2000 one customer accounted for 10.4% of accounts receivable. At December 31, 1999 two customers accounted for 13.8% and 13.2% of accounts receivable respectively.

As of December 31, 1999, 2000 and 2001 the group's cash and cash equivalents were deposited with major clearing banks in the UK in the form of money market deposits for varying periods of up to three months.

6 Investments

On February 1, 2001 the group purchased part of the business and assets of Noral Micrologics Limited for cash consideration of £1,351,000. The purchase consideration has all been treated as goodwill, as the book and fair value of the assets acquired was negligible.

On June 21, 2000 all of the issued share capital of EuroMIPS Systems SAS (now ARM France SAS) was purchased for cash consideration of £864,000; and on September 18, 2000 all of the issued share capital of Allant Software Corporation was purchased for cash consideration of £2,193,000.

Further to the cash consideration for the cost of the acquisitions, the acquisition agreements provide for cash bonuses and payments for post-acquisition pre-defined services provided by employees. These are being treated as payroll costs of the periods to which the services relate.

Following a detailed review of the acquired companies' balance sheets and their accounting policies it was considered that no fair value adjustments were necessary.

Following an independent valuation of the in-process research and development acquired with Allant Software Corporation, £150,000 was written off through the income statement.

The combinations have been accounted for using the purchase method.

Unaudited pro forma results of the Company and the acquired businesses have not been presented as the acquired businesses are immaterial to the Company's results.

In March 2000, the group disposed of part of its shareholding in Palmchip Corporation, reducing its holding from 45.4% to 4.9%. The group recognized a £0.5 million profit on the sale of these shares.

In 2001, the group disposed of two available-for-sale investments realizing a gain of £655,000. Impairments during 2001 against investments held at the year end amounted to £613,000.

7 Property and equipment

	December 31	
	2000	**2001**
	£000	**£000**
Owned buildings	190	**190**
Construction in progress – leasehold improvements	1,596	**75**
Leasehold improvements	6,354	**11,863**
Computers	7,889	**9,973**
Software	13,961	**24,370**
Fixtures, fittings and motor vehicles	2,434	**2,819**
	32,424	**49,290**
Less: accumulated depreciation	(17,550)	**(26,622)**
Property and equipment, net	14,874	**22,668**

Depreciation charged to income for the years ended December 31, 1999, 2000 and 2001, was £4,581,000, £6,246,000 and £9,327,000 respectively.

8 Intangible assets

	Goodwill 2000 £000	Patents 2000 £000	License 2000 £000	Total 2000 £000	**Goodwill 2001 £000**	**Patents 2001 £000**	**Licenses 2001 £000**	**Total 2001 £000**
At cost	4,243	–	2,822	7,065	**5,594**	**7,513**	**3,877**	**16,984**
Less: accumulated amortization	1,391	–	234	1,625	**3,320**	**–**	**1,325**	**4,645**
Net	2,852	–	2,588	5,440	**2,274**	**7,513**	**2,552**	**12,339**

Goodwill, being the difference between the fair value of the consideration and the fair value of the assets acquired, arose on consolidation of the following subsidiaries and businesses:

- Micrologic Solutions Limited, purchased in October 1999;
- EuroMIPS Systems SAS, purchased in June 2000 for cash consideration of £764,000 and associated costs of £100,000; goodwill of £779,000 arose;
- Allant Software Corporation, purchased in September 2000 for cash consideration of £2,124,000 and associated costs of £69,000; goodwill of £1,962,000 arose on the acquisition; £150,000 of in-process research and development was written off immediately;
- Infinite Designs Limited, purchased in March 2000 for cash consideration of £375,000; goodwill arose of £375,000 on this acquisition; and
- Noral Micrologics Limited, purchased in February 2001 for cash consideration of £1,351,000; goodwill of £1,351,000 arose on this acquisition.

Goodwill has been amortized on a straight-line basis over periods of up to three years, determined in each case by reference to employee turnover rates in the industry and the individual technology acquired with the acquisitions.

Licenses to use technology are being amortized over periods of three years to five years. The amortization periods for both licenses have been determined according to their estimated useful economic life.

Patents are being amortized over five years, being the period over which the group will derive benefit from them.

9 Shareholders' equity

Share capital There was a subdivision of shares in April 1999. Shareholders received four shares with a nominal value of 0.25 pence for every one share held with a nominal value of 1 pence. There was a further subdivision of shares in April 2000. Shareholders received five shares with a nominal value of 0.05 pence per share for every one share held with a nominal value of 0.25 pence.

On November 5, 1999, a QUEST was formed which purchased 3,900,000 ordinary shares of 0.05 pence each which were newly issued by the Company. On March 13, 2000, the QUEST purchased 1,483,440 ordinary shares of 0.05 pence and on November 7, 2000 the QUEST purchased a further 559,559 ordinary shares of 0.05 pence each, which were newly issued by the Company. These are for the purpose of satisfying the exercise of share options relating to the employee Save As You Earn schemes.

During the year, 14,531,805 shares were issued following the exercise of the same number of options, and 3,925,400 shares were allocated to employees from the QUEST following the exercise of the same number of options granted under the group's Save As You Earn scheme.

Share options The board is authorized to issue options to acquire ordinary shares in the Company up to a maximum of 10% of the issued ordinary share capital in any five-year period. Options issued prior to the listing of the Company are excluded from this calculation.

Under the UK Inland Revenue Approved Incentive Share Option Plan (the "Approved Scheme"), the Company may grant options to directors and employees meeting certain eligibility requirements. Options under the Approved Scheme are exercisable between three and ten years after their issue, after which time the options expire.

Under the Company's Executive Scheme (the "Executive Scheme"), for which it has not sought approval from the UK Inland Revenue, options are exercisable three to seven years after their issue, after which time the options expire. The Company also operates the US ISO Share Option Plan, which is substantially the same as the Executive Scheme, the main difference being that the vesting periods are different.

In 1998, the Company set up two savings-related share option schemes for all employees and executive directors of the group. The number of options granted is related to the value of savings made by the employee. The period of savings is three or five years except for employees of ARM, INC. where the period is two years. The option price is currently set at 85% of the market share price prior to the grant, and the right to exercise normally only arises for a six-month period once the savings have been completed except for ARM, INC. where the right to exercise normally only arises for a three-month period once the savings have been completed. The Company set up two further savings related option schemes in each of 1999, 2000 and 2001 for all employees and executive directors of the group, which have the same characteristics as those schemes set up in 1998.

9 Shareholders' equity continued

Option activity is summarized as follows:

	Outstanding options	
	Shares Number	Weighted average exercise price £
Balances, December 31, 1998	76,237,780	0.056
Granted in year	17,387,925	1.266
Lapsed in year	(1,130,045)	0.372
Exercised in year	(11,681,445)	0.026
Balances, December 31, 1999	80,814,215	0.318
Granted in year	5,867,630	6.171
Lapsed in year	(1,341,025)	1.884
Exercised in year	(38,338,347)	0.060
Balances, December 31, 2000	47,002,473	1.214
Granted in year	8,189,032	3.398
Lapsed in year	(1,283,752)	3.433
Exercised in year	(18,457,205)	0.136
Balances, December 31, 2001	**35,450,548**	**2.199**

The weighted average grant-date fair value of options granted during the year was £2.11 for executive options and £2.18 for sharesave options. The weighted average exercise price of options exercisable at December 31, 2001 was £1.03 (December 31, 2000: £0.05).

The following options over ordinary shares were in existence at December 31, 2001:

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	**Exercisable at December 31 2001**
975,000	0.02	4.5 years	1999 – 2006	**975,000**
600,000	0.02	2.5 years	1999 – 2004	**600,000**
2,037,800	0.026	5.2 years	2000 – 2007	**2,037,800**
58,030	0.026	0.2 years	1998 – 2002	**58,030**
15,000	0.026	0.3 years	1998 – 2002	**15,000**
8,000	0.026	2.3 years	2000 – 2004	**8,000**
80,000	0.0425	2.4 years	2000 – 2004	**80,000**
27,505	0.0625	0.5 years	1998 – 2002	**27,505**
70,000	0.0625	2.5 years	2000 – 2004	**70,000**
15,001	0.0625	0.8 years	1998 – 2002	**15,001**
395,000	0.0625	2.8 years	2000 – 2004	**395,000**
273,000	0.0625	3.0 years	2000 – 2004	**273,000**
1,050,000	0.1125	6.2 years	2001 – 2008	**1,050,000**
375,054	0.1125	1.2 years	1999 – 2003	**45,054**
164,329	0.3875	1.4 years	1999 – 2003	**82,829**
135,000	0.3875	3.4 years	2001 – 2005	**135,000**
220,000	0.5275	6.6 years	2001 – 2008	**220,000**
85,571	0.5275	1.6 years	1999 – 2003	**24,321**
103,000	0.405	6.8 years	2001 – 2008	**103,000**
37,250	0.405	1.8 years	1999 – 2003	**13,500**
3,918,960	1.224	–	2002 – 2009	–
2,319,918	1.224	2.2 years	2000 – 2004	**632,418**
7,148,040	1.224	–	2002 – 2006	–
173,260	1.338	–	2002 – 2009	–
41,254	1.338	2.3 years	2000 – 2004	**13,754**
42,740	1.338	–	2002 – 2006	–
75,490	1.765	–	2002 – 2009	–
50,004	1.765	2.6 years	2000 – 2004	**15,004**
26,010	1.765	–	2002 – 2006	–
91,570	4.26	–	2002 – 2009	–
76,680	4.26	–	2002 – 2006	–
128,125	7.738	–	2003 – 2010	–
52,500	7.738	3.1 years	2001 – 2005	**13,125**
76,125	7.738	–	2003 – 2007	–

9 **Shareholders' equity** continued

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	**Exercisable at December 31 2001**
80,465	6.136	–	2003 – 2010	**–**
10,000	6.136	3.3 years	2001 – 2005	**2,500**
36,035	6.136	–	2003 – 2007	**–**
50,000	6.27	3.3 years	2001 – 2005	**12,500**
394,369	6.155	–	2003 – 2010	**–**
840,500	6.155	3.4 years	2001 – 2005	**210,125**
2,859,842	6.155	5.4 years	2001 – 2007	**714,960**
24,250	6.70	3.6 years	2001 – 2005	**6,062**
170,000	6.70	5.6 years	2001 – 2007	**42,500**
145,750	6.33	3.8 years	2001 – 2005	**36,437**
275,000	6.33	5.8 years	2001 – 2007	**68,750**
88,000	4.43	–	2002 – 2006	**–**
444,000	4.43	–	2002 – 2008	**–**
625,725	3.35	–	2004 – 2011	**–**
1,364,400	3.35	–	2002 – 2006	**–**
3,956,275	3.35	–	2002 – 2008	**–**
125,818††	3.815	–	2008 – 2011	**–**
61,313	2.84	–	2004 – 2011	**–**
28,000	2.84	–	2002 – 2006	**–**
25,822	2.84	–	2002 – 2008	**–**
142,250	3.75	–	2004 – 2011	**–**
44,750	3.75	–	2002 – 2006	**–**
51,000	3.75	–	2002 – 2008	**–**
1,115,920*	0.2445	–	2003 – 2003	**–**
356,605**	1.099	–	2002 – 2002	**–**
137,530**	1.099	–	2004 – 2004	**–**
42,225***	5.65	–	2003 – 2003	**–**
4,896***	5.65	–	2005 – 2005	**–**
3,681***	5.65	–	2002 – 2002	**–**
651,677†	3.069	–	2004 – 2004	**–**
144,393†	3.069	–	2006 – 2006	**–**
204,841†	3.069	–	2003 – 2003	**–**
35,450,548				**7,996,175**

* These relate to options granted on April 17, 1998 under the Company's savings related share option schemes.

** These relate to options granted on June 10, 1999 under the Company's savings related share option schemes.

*** These relate to options granted on May 19, 2000 under the Company's savings related share option schemes.

† These relate to options granted on May 19, 2001 under the Company's savings related share option schemes.

†† These share options normally vest after seven years. If however, the Company achieves real EPS growth of 10% above the rate of inflation per annum for a period of three years, then all the options will be exercisable after three years.

All option information presented above has been restated, where applicable to reflect the four-for-one share subdivision in April 1999 and the five-for-one share subdivision in April 2000.

9 Shareholders' equity continued

At December 31, 2001, the Company had three share option plans and six savings-related share option schemes. The Company applies APB Opinion No. 25 and related interpretations in accounting for its plans. Non-cash compensation relating to stock options granted in the year ended December 31, 1997 and in March 1998 at an exercise price below the fair value of the underlying stock on the grant date was recognized in an amount of £736,000 in the year ended December 31, 1999. No compensation cost remained to be recognized in the years ended December 31, 2000 or December 31, 2001. Such cost has been allocated according to the functional areas of the relevant employees as research and development expense in an amount of £nil (2000: £nil; 1999: £284,000), sales and marketing expense in an amount of £nil (2000: £nil; 1999: £268,000) and general and administrative expenses in an amount of £nil (2000: £nil; 1999: £184,000).

Had compensation cost for the Company's share option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123, the group's net income and earnings per share would have been changed to the pro forma amounts indicated below:

	Year ended December 31		
	1999 £000	2000 £000	**2001 £000**
Net income:			
As reported	16,232	29,377	**34,002**
Pro forma	13,657	21,112	**22,392**
Basic earnings per common share (pence):			
As reported	1.7p	3.0p	**3.4p**
Pro forma	1.4p	2.2p	**2.2p**
Diluted earnings per common share (pence):			
As reported	1.6p	2.9p	**3.3p**
Pro forma	1.3p	2.1p	**2.2p**

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999: risk-free interest rate of 5.1% (2000: 6.0%; 1999: 4.85%); expected life of four years; 79% (2000: 74%; 1999: 80%) volatility; and no dividends.

The earnings per share disclosures noted above have been restated to reflect the share subdivisions in April 1999 and April 2000 as applicable.

10 Commitments

The group leases its office facilities and certain equipment under non-cancelable operating lease agreements which expire at various dates through 2018.

Future minimum lease commitments at December 31, 2001, are as follows:

Years ending December 31	Operating leases £000
2002	3,121
2003	3,059
2004	2,956
2005	2,587
2006	2,261
Thereafter	19,792
Total minimum lease payments	33,776

Rental expense under operating leases totaled £1,291,000, £2,746,000 and £2,950,000 for the years ended December 31, 1999, 2000 and 2001 respectively.

The Group has an obligation to make a $3,000,000 investment representing a minority holding in a "fabless" semiconductor company in the event that this is set up during 2002 to create and sell ARM core-based microprocessor cores to be licensed from ARM.

11 Geographic and segment information

The group operates in, and is managed as, a single segment.

The following analysis is of revenues by geographical segment and origin and long-lived assets by group companies in each territory:

	Year ended December 31		
	1999	2000	**2001**
	£000	£000	**£000**
Revenues (by market destination):			
Europe	8,169	20,616	**27,103**
United States	33,091	55,233	**72,271**
Japan	16,898	18,007	**33,548**
Asia Pacific excluding Japan	3,962	6,874	**13,352**
Total revenues	62,120	100,730	**146,274**

The group's exports from the United Kingdom were £57,610,000, £87,096,000 and £128,303,000 for the years ended December 31, 1999, 2000 and 2001 respectively.

	Year ended December 31		
	1999	2000	**2001**
	£000	£000	**£000**
Revenues (by origin):			
Europe	58,210	90,248	**131,136**
United States	2,340	5,608	**8,431**
Asia Pacific	1,570	4,874	**6,707**
Total revenues	62,120	100,730	**146,274**
Long-lived assets:			
Europe	8,574	23,194	**35,042**
United States	1,730	3,677	**3,353**
Asia Pacific	100	77	**167**
Total long-lived assets	10,404	26,948	**38,562**

In 1999 and 2001 no single customer accounted for more than 10% of total revenues. In 2000, one US customer accounted for 15% of total revenues.

12 Fair values of financial instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash and cash equivalents and accounts receivable The carrying amount approximates fair value because of the short maturity of those instruments.

Foreign currency forward contracts The fair value of foreign currency forward contracts is estimated using the settlement rates prevailing at the period end.

The estimated fair values of the group's financial instruments are as follows:

	Year ended December 31					
	1999		2000		**2001**	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000	**Carrying amount £000**	**Fair value £000**
Cash and cash equivalents	51,804	51,804	75,266	75,266	**104,467**	**104,467**
Accounts receivable	13,700	13,700	18,913	18,913	**24,809**	**24,809**
Foreign currency contracts	2	2	551	551	**355**	**355**

Report of independent accountants/US format

To the board of directors and shareholders of ARM Holdings plc In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of cash flow present fairly, in all material respects, the financial position of ARM Holdings plc and its subsidiaries at December 31, 2001 and 2000 and the results of their operations and their cash flow for the years ended December 31, 2001, 2000 and 1999 in conformity with generally accepted accounting principles in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with generally accepted auditing standards in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion expressed above.

PricewaterhouseCoopers.

PricewaterhouseCoopers Chartered Accountants
Cambridge, England
February 11, 2002

Group directory

ARM Holdings plc
110 Fulbourn Road
Cambridge CB1 9NJ
United Kingdom
Tel: +44 1223 400400
Fax: +44 1223 400410

ARM Ltd
Liberty House
Moorbridge Road
Maidenhead
Berkshire SL6 8LT
United Kingdom
Tel: +44 1628 427700
Fax: +44 1628 427701

Sheffield Science Park
New Spring House
231 Glossop Road
Sheffield S10 2GW
United Kingdom
Tel: +44 114 282 8000
Fax: +44 114 282 8001

Blackburn Design Centre
Belthorn House
Walker Road
Blackburn BB1 2QE
Tel: +44 1254 893900
Fax: +44 1254 893901

ARM France
12 Avenue des Prés
Montigny le Bretonneux
78059 Saint Quentin en Yvelines, Cedex
France
Tel: +33 1 30 79 05 10
Fax: +33 1 30 79 05 11

Les Cardoulines B2
Route des Doline
Sophia Antipolis
06560 Valbonne
France
Tel: +33 4 92 96 88 60
Fax: +33 4 92 96 88 79

ARM Germany
Rennweg 33
85435 Erding
Germany
Tel: +49 8122 89209 0
Fax: +49 8122 89209 49

ARM, INC.
1250 Capital of Texas Highway
Building 3, Suite 560
Austin, TX 78746
USA
Tel: +1 512 327 9249
Fax: +1 512 314 1078

1902 Wright Place
Suite 200
Carlsbad, CA 92008
USA
Tel: +1 760 918 5536
Fax: +1 760 918 5539

750 University Avenue
Suite 150
Los Gatos, CA 95032
USA
Tel: +1 408 579 2200
Fax: +1 408 579 1205

300 W Main Street
Suite 215
Northborough, MA 01532
USA
Tel: +1 508 351 1670
Fax: +1 508 351 1667

18300 Union Hill Road
Suite 257
Redmond, WA 98052
USA
Tel: +1 425 882 9781
Fax: +1 425 882 9782

Walnut Creek Design Center
1981 N Broadway
Suite 245
Walnut Creek, CA 94596
USA
Tel: +1 925 944 9690
Fax: +1 925 944 9612

Crystal Glen Center
39555 Orchard Hill Place
Suite 600
Novi, MI 48375
USA
Tel: +1 248 374 5055
Fax: +1 248 374 5056

ARM KK
Daini-Ueno Building 8F
3-7-18 Shin-Yokohama
Kohoku-Ku, Yokohama-Shi
Kanagawa 222-0033
Japan
Tel: +81 45 477 5260
Fax: +81 45 477 5261

ARM Korea Limited
Room 1115
Hyundai Building
9-4, Soonae-Dong
Boondang-Ku
Sungnam
Kyunggi-do 463-020
Korea
Tel: +82 31 712 8234
Fax: +82 31 713 8225

ARM Taiwan Limited
8F no 50
Lane 10
Kee Hu Road
Nei Hu
Taipei (114)
Taiwan
Tel: +886 2 2627 1681
Fax: +886 2 2627 1682

ARM Israel
23 Hataa-as St
44425 Kfar Saba
Israel
Tel: +972 9 7678040 extension 201
Fax: +972 9 7677020

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ARM Holdings plc
110 Fulbourn Road
Cambridge CB1 9NJ
United Kingdom

Telephone +44 1223 400400
Facsimile +44 1223 400410

Further information available at:
www.arm.com

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