ARM®

Annual report and accounts 2002

Contents

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.

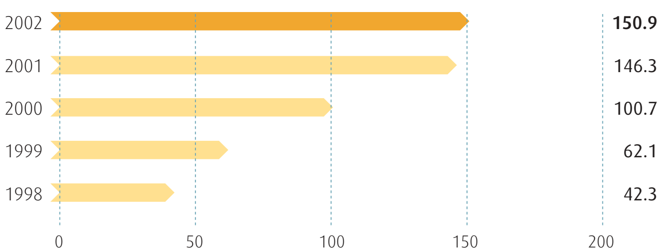
If you use a mobile telephone, a personal organiser, watch digital TV or access the internet, you are likely to be using a product which has our technology at its core.

Cover: Lava flowing into the Pacific Ocean, Hawaii. The power of lava is usually hidden from view, at the heart of a volcano. The power of ARM IP is at the heart of its Partners' products.

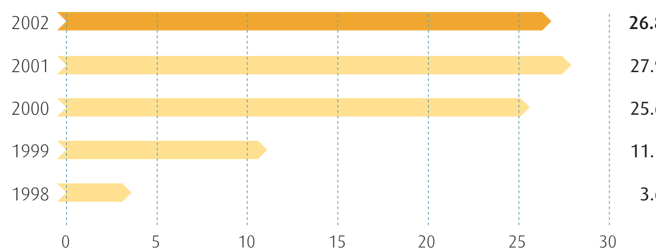
ARM at a glance

- Total revenues up by 3% (7% at constant exchange rates) in 2002, to £150.9 million
- Our Partners shipped a total of 456 million chips in 2002 based on ARM technology
- The first core from the ARM11™ family of products was successfully delivered to lead Partners in December

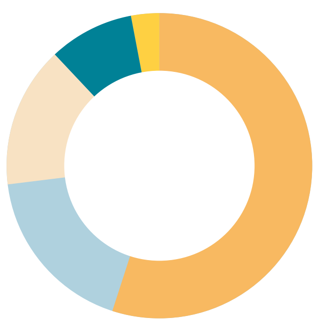
Revenues (£m)



Royalty revenues (£m)

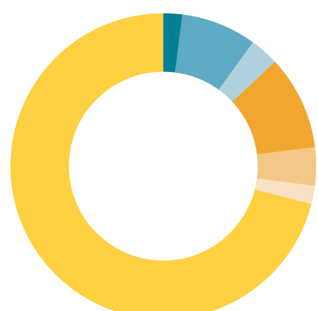


Revenue analysis (%)



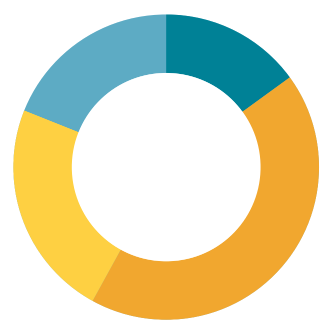
Licensing	55%
Royalties	18%
Development systems	15%
Support, maintenance and training	9%
Consulting	3%

Royalty units (%)



Automotive	2%
Consumer	8%
Imaging	3%
Networking	10%
Secure	4%
Storage	2%
Wireless	71%

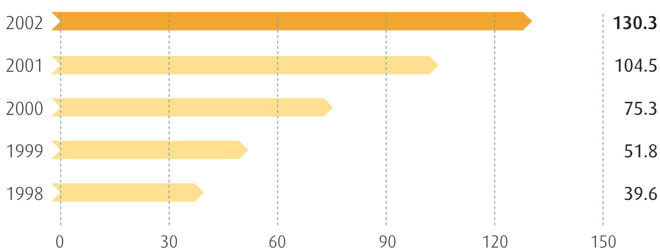
Licence revenues by product (%)



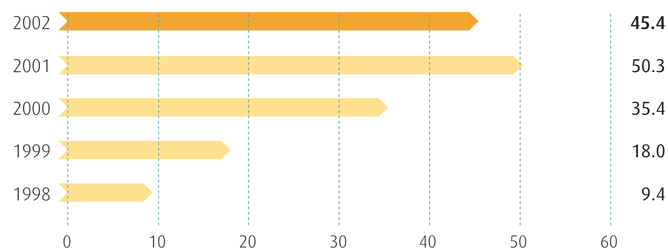
ARM7™ family	15%
ARM9™ family	43%
ARM10™/ARM11/architecture	23%
Non-core licensing	19%

- ARM remains strongly profitable and cash-generative, despite lower revenues in the second half of the year
- The global reach of ARM's business extended further with the opening of our office in China

Net cash balance at year end (£m)



Income before tax (US GAAP) (£m)



Geographic revenue by market destination

United States 44%

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

Asia Pacific 38%

Seoul, South Korea
Taipei, Taiwan
Shin-Yokohama, Japan
Shanghai, PR China

Europe 18%

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

Chairman's statement

ARM's competitive position in the intellectual property (IP) licensing business improved during 2002, despite tough trading conditions. Although the short-term trading outlook is flattish, our long-term objective to become the architecture for the digital world remains on track.

Results

We finished the year with total revenues up 3%, to £150.9 million, and licensing revenues up 8%, to £83.0 million. Profit before tax was down slightly to £47.5 million, from £50.6 million in 2001, before restructuring costs of £2.0 million in 2002. Improved management of our working capital contributed to an increase in our cash and short-term investments to £130.3 million, from £104.5 million at the end of the previous year.

The market

The challenging economic environment and downturn in the semiconductor industry persisted throughout 2002. While we showed a healthy growth in the first half of the year, the industry slow-down caught up with us in the second half as a number of our Partners deferred placing licensing orders from quarter to quarter and, as a result, licensing activity slowed down.

This led us to revise our short- to medium-term revenue expectations in the fourth quarter and to adjust our cost base accordingly. ARM continues, however, to report strong profits and to generate cash, and we have persevered with our policy of investing in the Company's future by maintaining a high level of expenditure on research and development.

Geographic expansion

In July 2002, we opened an office in Shanghai, in the People's Republic of China. ARM Consulting (Shanghai) Co. Ltd., will help to create a comprehensive value chain for the country's electronics industry by supporting existing and prospective Partners, and by becoming involved in initiatives such as technology transfer and university programmes.

People

In the fourth quarter, in response to the declining market, we took the painful, but necessary, decision to reduce our total workforce by approximately 12%; at the end of the year we employed 721 people, taking us back to the number we employed at the end of 2001. The reductions, which were made across all levels and business areas, will save approximately £5 million a year in employment costs.

In March 2002, Chief Financial Officer Jonathan Brooks retired from the Company and we were pleased to welcome Tim Score as his replacement; in August 2002, Pete Magowan, Vice President of Business Development, left us to enter the venture capital industry, and Mike Inglis was appointed to the ARM Holdings plc board as Executive Vice President, Marketing. I would like to thank both Jonathan and Pete for their significant contributions to the Company's development.

We strengthened the operational board of the company by appointing Colm MacKernan as General Counsel and by promoting Simon Segars, Executive Vice President, Engineering, and Jerry Ardizzone, Executive Vice President, Worldwide Sales, to the executive team.

We appreciate the hard work and creativity of all our people and thank them for their contribution.

Legal action

In May 2002, Nazomi Communications, Inc. filed a lawsuit before the Federal District Court for Northern California, claiming that our Jazelle® technology for Java acceleration infringes a US patent owned by Nazomi. We are confident that our products do not infringe the patent cited in the law suit or any other Nazomi patent.

We believe that this action is more straightforward than the litigation with picoTurbo Inc., which was concluded in December 2001, and expect the cost and management time to be significantly less. We believe that the matter could be concluded quickly.

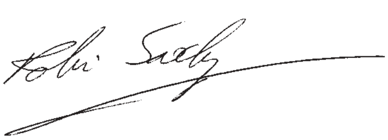
We are now protecting our IP even more vigorously. We filed twice as many patent applications in 2002 as in the previous year and now have more than 230 patent families which cover the scope of our activities; these comprise 738 patents on file around the world, 245 of which have matured into issued patents.

Current trading and prospects

The strategic nature of our relationships with our Partners enables us to be optimistic about our prospects but, in the current climate, the timing of the completion of licensing deals is difficult to predict. In addition, our reported revenues are exposed to any further weakening of the US dollar. As a result, we expect our quarterly revenues to be fairly flat during 2003.

We have, however, received positive feedback from our Partners on our new ARM1136J-S™ and ARM1136JF-S™ processors. During the year, we will introduce other new cores, platform products and Development Systems products, which should further stimulate demand.

Over the longer term, we believe that the industry downturn will serve only to strengthen our market position. The accelerating pace behind the ARM architecture is illustrated by the expansion of the third-party community of companies that have chosen to work closely with us. The quality and flexibility of our architecture, combined with our focus on high performance at low cost, and on good power efficiency, not only differentiates us from our competitors, but also makes us the preferred partner for many of the world's leading semiconductor manufacturers.



Sir Robin Saxby Chairman

Chief Executive Officer's review

2002 was a challenging year for our industry and for ARM. The strength of our Partnership business model and the passion and commitment of our employees, however, enabled us to finish 2002 a significantly stronger company than at the end of the previous year.

Partnerships

Our Partnerships continue to be a key ingredient in our commercial success. During 2002, we signed 33 new Partners and 70 new licences: 46 multi-use licences and 24 per-use licences. Of the 33 new Partners signed during the year, 23 took per-use licences through our Foundry Programme. At the end of 2002, we had 108 semiconductor Partners compared with 77 at the end of 2001.

In the fourth quarter of the year, US-based company Flextronics, one of the world's largest providers of electronics manufacturing services, became the first licensee in our new Approved Licensing Programme. This enables Flextronics to sub-license ARM products as part of a wider design services offering.

Significant opportunities exist to license our technology to new Partners and to license new technology to our existing Partners; for example, in the fourth quarter we announced that LSI Logic, Qualcomm and Texas Instruments were among the first five licensees of the ARM1136J-S processor, the first core from the ARM11 microarchitecture, based on the ARMv6 architecture. In addition to licensing products on a per-use basis, we also license non-Central Processing Units (CPUs), which include hardware platforms, application software, models and peripherals, to new and existing Partners.

The revenue from the licensing of non-CPU technology increased during the year to £12.6 million, compared with £11.9 million in the previous year. The PrimeXsys™ Platform, which we launched in 2001, and which enables licensees to improve the time-to-market of their application solutions, had been licensed to four Partners by the end of 2002. During the year, we also announced the availability of the PrimeXsys Dual Core Platform, which is primarily for use in networking applications.

In 2002, the proportion of licence revenues earned from existing Partners increased to 89%, from 80% in 2001, and, as our Partner base grows and the number of available products extends, our ability to sign upgrade and derivative licences will increase.

The Foundry Programme

Our Foundry Programme, which we introduced in 2000, continued to expand. Under this Programme, we make our technology available to small "fabless" companies (companies which do not have the facility to fabricate silicon), by licensing it on a per-use basis. The fabless companies then have their chips manufactured by one of our Foundry Partners. During the year, four more foundries joined the Programme, making a total of seven.

Our first per-use licensee began shipping ARM Powered® devices in the first quarter of 2002; by the end of the year the number of per-use licensees shipping product had increased to six. Four of our 19 cores which are available for multi-use licensing have been introduced into the Foundry Programme.

When we established the Programme, we envisaged that some per-use licensees would upgrade to multi-use licences and, to date, four have done so.

The Programme's lower up-front licence fees, but higher per-unit royalties, have attracted a large number of Partners and have, therefore, increased the number of licences sold without having an adverse impact on the pricing of our multi-use licences.

Royalties and unit shipments

During 2002, our semiconductor Partners shipped a total of 456 million ARM core-based devices, earning total royalty revenues of £26.8 million. Royalty revenues are affected by many factors, including the number of ARM

Partners shipping and the mix of core-based chips being sold; the newer cores tend to generate higher per-unit payments. Of all the ARM core-based chips sold, 93% have been based on ARM7 technology but, as royalties are earned on more recent ARM9, ARM10 and ARM11 core-based chips, we expect the average royalty per chip to increase. In the longer term, chips sold by per-use licensees will have a positive impact on the average royalty rate, reflecting the different business model deployed in the Foundry Programme.

Royalties are now being earned from products being shipped in all target end markets – automotive, consumer entertainment, imaging, mass storage, microcontrollers, networking, secure and wireless. The wireless market, in which we include personal organisers, continued to be the largest contributor to royalty revenues, accounting for approximately 64% (11% of total revenues).

Development Systems

After a very strong start to the year, sales of Development Systems slowed and ended the year at £23.1 million, marginally down on the £23.3 million reported in 2001. Encouragingly, however, sales of the RealView® Development Solution, which is an important indicator of the level of ARM technology-based development activity, were up year on year. The RealView Development Solution provides a complete software development solution for creating applications based on our architecture.

We expect our recently-introduced RealView tools to have a positive effect on sales in 2003. Revenues from the sales of Development System products illustrate the global reach of the ARM® architecture: 40% are sold in East Asia, 31% in Europe and 29% in the US; 30% of these were sold through our network of distributors.

Product development

Research and development continues to be high on our agenda. ARM was built on innovation and the new and exciting products we develop will be the key to our future success. Our objective is to deliver competitive advantage to our Partners in all the end markets they target. In 2002, our investment in research and development increased by 25%, to £48.7 million, and represented 32% of sales.

In the fourth quarter of 2002, we made the first deliveries of the ARM1136J-S core, which is designed to meet the low-power needs of battery-powered and high-density embedded applications, and is ideal for innovative applications in networking, wireless, automotive and consumer entertainment.

I congratulate the engineers who worked on the development of the ARM1136JF-S core, which was recently voted IP Processor of 2002, by the analysts of Microprocessor Report.

During the year, we launched the ARM11 PrimeXsys Platform for wireless applications, and the PrimeXsys Dual Core Platform for networking applications. These platforms provide system developers with all the hardware, software and verification IP necessary to design a system on chip (SoC). We also announced a technology collaboration, aimed at prolonging the battery life of mobile devices, with National Semiconductor.

Our technology has been licensed to many of the world's leading semiconductor companies and many of our Partners have demonstrated their confidence in it by increasing the number of products they license from us. Around two-thirds of the top 150 semiconductor companies have not yet, however, licensed our technology. These opportunities that exist, combined with the flexibility of our licensing models and the ARM total solution offering, combine to give us confidence in the future.

Warren East.

Warren East Chief Executive Officer

forging relationships

The Partnerships we have formed with major semiconductor companies, such as Philips, Texas Instruments (TI) and Toshiba, have served us well and continue to do so. TI, for example, was one of the first licensees of the ARM1136J-S product, while Toshiba and Philips were two of more than 25 Partners to sign up to provide support and technical contributions towards the development of the next generation of AMBA™ 3.0 technology, an established industry methodology for system-on-chip (SoC) module assembly.

Our overriding culture of meeting the market's constantly evolving needs has led us to develop a number of different styles of Partnership. These range from our original business model, under which we license our microprocessor cores, to our Foundry Programme, which was developed to enable smaller, fabless, companies to benefit from our expertise.

Whereas our larger Partners license our technology on a multi-use basis, the smaller, and typically one-product, companies license our IP on a per-use basis. They produce silicon through one of our seven Foundry Partners (wafer fabricators), which hold licences to manufacture using our cores. This enables these smaller companies to mitigate risk and to bring their ARM Powered products to market quickly.

More recently, a newer type of Partner has emerged to participate in the ARM Approved Licensing Programme. This programme enables Partners to sub-license ARM core technology and, thereby to provide their customers with end-to-end services. The benefits to these customers, principally original equipment manufacturers (OEMs), of dealing with one party for IP, design and manufacturing are lower costs and improved time-to-market. Our first Partner in this new programme is US-based Flextronics Semiconductor.

Our Subscription Licence model, which we developed for some of our larger Partners, enables them to pay an annual fee and to use our IP during that period. This saves time and legal costs because Partners are able to access our technology on demand under a single legal agreement. It also helps us to promote the use of our IP in these companies because it gives development groups which are planning new designs, quick and easy access to our technology.

Our ARM Technology Access Programme (ATAP) extended and formalised our relationship with design service companies which, by specialising in designing SoC implementations, enable product development teams to focus on differentiation and adding value. We verify that each centre is able to meet the needs of the growing number of our Partners which choose to outsource all, or part of, their design or manufacturing activities.

We introduced a further initiative, our Approved Training Centre (ATC) programme, to extend and formalise existing relationships. This increases the number of organisations which are authorised to provide ARM training. We give their teaching staff intensive training and monitor them regularly to ensure that they continue to meet our standards.

ARM's many types of Partners include an entire community of organisations which align their products and services around the ARM architecture. These include leading Operating Systems and Real Time Operating Systems (RTOS) providers, EDA companies, application software providers, and tools developers. Each contributes to our network of Partners by enabling a wide range of technology solutions that support the development of ARM Powered products. This makes our architecture one of the most widely supported 32-bit RISC microprocessor solutions available today.

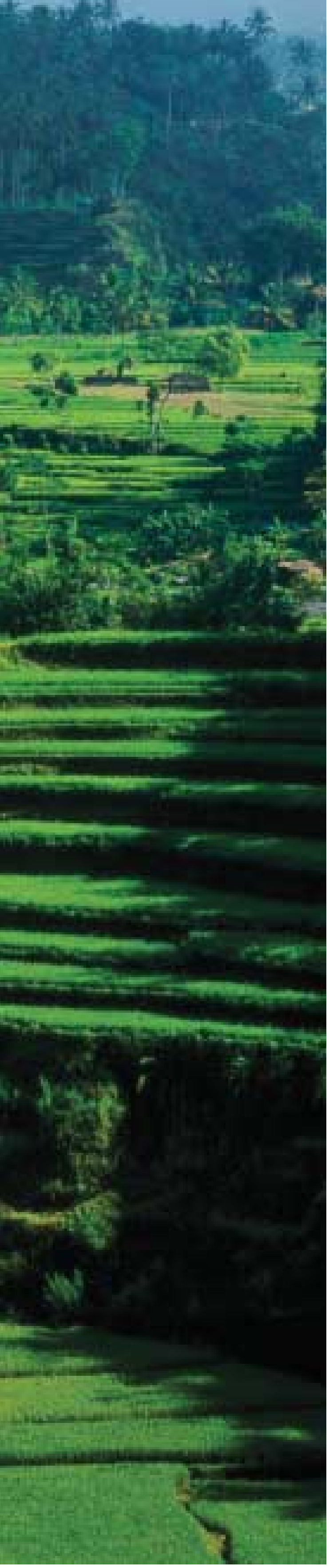
As the market evolves, we will continue to create innovative business models to enable us to take advantage of new opportunities as well as to provide access to our technology for an entirely new generation of companies.

We have a "can do" culture and have always been prepared to find ways to deliver what our Partners need.

Above right: Iceberg Alley, off Newfoundland, Canada. Icebergs are usually found in groups, in which they stay and migrate. ARM's relationships with its Partners are similarly stable and long lasting.

ARM's Partnership culture has had a major role to play in the Company's success and, in recent years, new and different Partnership models have been introduced to enable more companies to join the ARM community.

ARM provides the tools and the methodologies, including compilers, debuggers, and development boards to enable developers to design and debug their hardware and software, and to deliver complete solutions.



enabling solutions

Our silicon Partners develop complex chips which will power the next generation of systems products. Our PrimeXsys Platform solutions help them to get their products to market more quickly by speeding up the process. In 2002, we introduced our ARM11 PrimeXsys Platform at the same time as the first of our new ARM11 CPU cores. The PrimeXsys Platform, which standardises key functions, enables our Partners to focus on creating differentiated products.

Our RealView family of development tools has been developed to support what are described as multi-core designs, in which our Partners may be integrating one or several ARM cores, together with a Digital Signal Processor (DSP) core from another source. Because silicon processes now have much finer geometry, more transistors can be put on a single chip, which makes the SoC very complex. RealView tools simplify the process of debugging and developing the software for multi-core design.

Our RealView tools provide designers with the best solution for creating and analysing systems based on our technology. They are designed and used by the same engineers who created our architecture. We test them to the highest level of pre- and post-silicon evaluation and development. As a result, the ARM RealView Development Solution provides the broadest possible range of support for future ARM architectures and derivatives. ARM RealView tools are fully integrated and provide a complete solution to any design or SoC integration; they give the developer a higher level of confidence in getting the product right first time and, therefore, speed the time-to-market.

AMBA technology is a further example of an ARM methodology which enables product designers to achieve a total solution. It is an open standard, which is available from our website through a simple licence agreement, and is free. It is widely supported by our Partners and is equally widely accepted as a standard for on-chip interconnect.

In December, we announced the next generation of the AMBA specification: more than 25 industry-leading companies are collaborating with us on the development of the AMBA 3.0 methodology. Given the strength of commitment to this programme, the technology will benefit from the most comprehensive industry-wide support possible for a communication methodology.

In November 2002, we formed an innovative strategic alliance with US-based National Semiconductor. We are combining our Intelligent Energy Manager™ with National Semiconductor's PowerWise™ technology, to increase the battery life of mobile telephones, initially by 25–75%, but eventually by as much as 400%.

By adjusting performance and power consumption in real time, we can save energy and meet end-users expectations. At a time when mobile, or cell, phones are increasingly using power-hungry applications, such as colour, video clips and gaming, this is an important progression.

We achieved a similarly innovative agreement with Synopsys Inc., the leading design company for complex integrated circuits, to give them access to our IP. We collaborated with them on developing a methodology which enables them to build an ARM core very quickly.

Working together in this way has enabled our silicon Partners to get their products to market more quickly and, thereby, to gain competitive advantage.

Above left: Terraced paddy fields, near Klung Kung, Bali. An ability to achieve maximum production from limited capacity equally describes ARM's drive to enable complete solutions.

pioneering
technologies

At ARM, we always remember that users of ARM Powered devices will continue to expect new products to have an increasing level of functionality; we see our job as delivering the best combination of processing performance and low-power usage from ARM cores to facilitate that. We have steadily expanded and improved our architecture over the years and, during 2002, introduced a number of new products which significantly extend our architecture's performance.

In April, we announced the ARM11 microarchitecture and, in October, announced the first implementations of our ARM1136J-S and our ARM1136JF-S cores. These are highly flexible and deliver new levels of performance, functionality and flexibility. They provide the technology for innovative SoC design for a wide range of applications which touch our everyday lives, from hand-held portable communicators, such as PDAs, and internet appliances, to digital TVs, laser printers, and automotive and industrial control systems.

The ARM1136JF-S core was recently selected as the winner of the 2002 Microprocessor Report Analysts' Choice Award in the Embedded IP category.

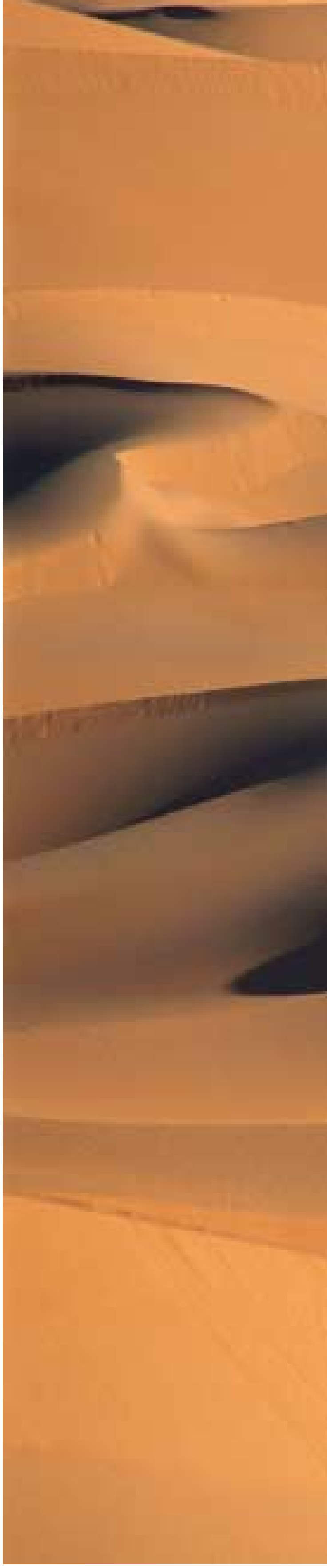
We announced our ARM11 PrimeXsys Platform at the same time as the ARM11 family of cores. This platform provides system developers with all the hardware, software and verification IP they need to design SoC solutions. It includes out-of-the-box support for Real Time Operating Systems (RTOS) and open operating systems, such as SymbianOS and WindowsCE. The platform increases design productivity and saves time and cost for developers.

We extended the PrimeXsys family when we introduced our Dual Core Platform for networking applications. This enables the performance of devices, such as modems, routers and switches, to be improved without a concomitant increase in heat and power, and also enables developers to integrate their own IP while retaining the flexibility to meet rapidly-changing market demands.

We made the first deliveries of the ARM11 microprocessor cores family in the fourth quarter of the year. The ARM11 cores were developed together with our PrimeXsys Platform to create a fully compatible and extendable system. The cores feature our innovative high-performance, low-power instruction set architecture which facilitates the building of the next generation of high-volume products, ranging from mobile phones, PDAs and games consoles to wireless networking solutions and automotive powertrain control systems.

Our objective is to provide the best and most innovative technology. We offer the widest range of cores and peripheral IP in the market because our focus is on meeting all our Partners' needs. Our integrated products give our Partners flexibility and choice and have led to us becoming the industry leaders in enabling solutions. There is a real benefit to our Partners if they standardise on the ARM architecture: they can streamline their processes by training their engineers to use one architecture and to work with one set of tools.

We have licensed our technology to many of the world's leading semiconductor companies. Their confidence in it is evidenced by the increasing number of ARM Powered products in production today.



Above right: Sahara Desert, Ouargia, Algeria. Innovative means are needed to make deserts bloom. ARM's innovations create new ways of solving problems.

ARM has always focused on technical innovation and, within that, on delivering high performance at low power and low cost. We continue to increase performance and reduce power.

Directors and advisers

Sir Robin Saxby age 56
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 of 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. He is a non-executive director of Glotel plc.

Warren East age 41
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.

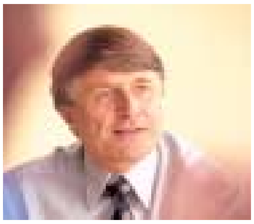
Tim Score age 42
Chief Financial Officer
Tim Score joined the Company as Chief Financial Officer and Director in March 2002. Before joining ARM, he worked as Finance Director of Rebus Group Limited, a private equity-funded software and IT services company. Between 1997 and 1999, he was Group Finance Director of William Baird plc, which he joined from LucasVarity plc, where he was Group Controller between 1996 and 1997. Between 1991 and 1995 he worked for BTR plc, where he was Group Financial Controller from 1992.

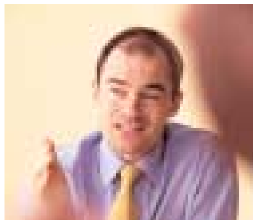
Tudor Brown age 44
Chief Operating Officer
Tudor Brown has been with ARM since its inception. He was previously with Acorn Computers where he was Principal Engineer, working exclusively on the ARM R&D programme from 1984. He served as Engineering Director and Chief Technical Officer from 1993 until October 2000 when he was appointed Executive Vice President Global Development. In October 2001 he was appointed to the board as Chief Operating Officer.

Mike Inglis age 43
Executive Vice President, Marketing
Mike Inglis joined ARM as Executive Vice President, Marketing, in June 2002 and was appointed to the board in August 2002. He brings with him over 18 years' experience in the semiconductor industry. From 1999 to 2002, Mike led the UK Communications and High Technology team at A.T. Kearney Management Consultants. Before this, he held a number of senior operational and strategic marketing positions at Motorola. Before joining Motorola, Mike worked as a Marketing and Design Manager at Texas Instruments in its European ASIC, PAL and FPGA group.

Michael Muller age 44
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 59
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 Director of Planning and, from 1987, as Group Strategy Development Director. 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 a number of companies listed in the UK, including Compass Group plc, The Capita Group plc, Christian Salvesen plc, Express Dairies plc and Johnston Press plc.


Sir Robin Saxby


Warren East


Tim Score

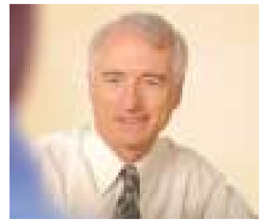

Tudor Brown


Mike Inglis


Michael Muller


Peter Cawdron


Doug Dunn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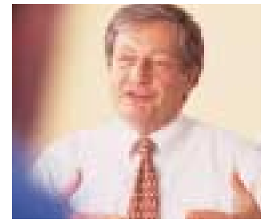
John Scarisbrick

Doug Dunn age 58
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 that 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 ST Microelectroncis NV and Sendo Holdings plc.

Lawrence Tesler age 57
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 50
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. He was appointed Chairman of Cambridge Positioning Systems Ltd in October 2002.

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Financial review

ARM continues to be profitable and cash generative despite the prolonged downturn in the semiconductor industry which resulted in a slowdown in licensing activity during the second half of 2002. We will continue to exercise stringent management of our cost base during 2003 to enable us to mitigate the impact of lower revenues on profitability.

Results

Total revenues for the year ended 31 December 2002 were up 3% at £150.9 million against £146.3 million in the year ended 31 December 2001. The effective US dollar-to-sterling rate, at $1.50 to the pound in 2002 against $1.45 the previous year, had the effect of reducing total reported revenues by approximately £5.8 million.

Product revenues, which include licence fees, royalties and the sale of Development Systems products, were £132.9 million and represented 88% of the year's total revenues, compared with £128.0 million and 87% in 2001. Royalty revenues, at £26.8 million compared with £27.9 million in the previous year. There are now 37 multi-use and six single-use licensees shipping silicon chips based on our architecture. Licensing revenues increased by 8% to £83.0 million in 2002, compared with £76.8 million in 2001. Sales of Development Systems products, however, decreased slightly from £23.3 million in 2001 to £23.1 million in 2002.

Service revenues, which include consulting services and revenues from support, maintenance and training, were also slightly down in 2002 at £18.0 million, 12% of total revenues, compared with £18.3 million, 13% of revenues, in 2001. Consulting revenues declined to £4.4 million from £7.4 million in the previous year as resources were reallocated from consulting projects to research and development activities. Revenues from support, maintenance and training increased by 24% to £13.6 million, from £10.9 million in 2001.

Gross margin

Gross margin for 2002 improved to 91% against 88% for the previous 12 months as a result of the reallocation of resources from consulting projects to research and development activities, and decreased sales of Development Systems resulting in lower cost of goods sold.

Operating expenses

In line with our strategy of continuous innovation,our investment in research and development increased in 2002 to £48.7 million, 32% of revenues, from £38.9 million, 27% of revenues, in the previous year. Sales and marketing costs also increased, to £24.5 million, 16% of revenues, from £21.4 million, 15% of revenues, in 2001. As a result of a reduction in legal costs, administrative expenses reduced to £21.5 million, 14% of revenues, from £22.8 million, 16% of revenues in 2001.

Restructuring costs of £2.0 million were incurred in the year as a result of a reduction in the total workforce by approximately 12%, to 721 at year end, giving rise to projected annual savings in employee costs of approximately £5 million.

Operating margin

Operating margin decreased to 27% in 2002, from 31% in 2001, as a result of the reduced revenues reported in the second half of 2002.

Interest

The benefit of higher cash balances was offset by lower interest rates in 2002, resulting in interest for the 12 months of £4.4 million, compared with £4.5 million in the previous year.

Earnings and taxation

Profit before taxation was £45.5 million, 30.1% of revenues, compared with £50.6 million, 34.6% of revenues, in the previous year. The group's taxation rate decreased to 29% in 2002, from 31% in 2001, partly as a result of research and development tax credits which have been available in the UK since April 2002.

Fully diluted earnings for the year were 3.2 pence a share compared with 3.4 pence for the previous year.

Balance sheet and cash flow

Net cash inflow of £52.1 million was generated in the 12 months to 31 December 2002; capital expenditure was £15.6 million and cash and short-term investments increased by £25.8 million to £130.3 million, from £104.5 million at the end of 2001.

Trade debtors decreased to £20.5 million, from £24.8 million at the end of 2001. The provision for doubtful debts increased to £2.2 million from £0.8 million in 2001, which was a reflection of the number of smaller Partners which were generated by the success of our Foundry Programme. Deferred income was £14.4 million at the end of December, compared with £19.4 million at the end of December 2001.

The board of directors reviews the structure of the balance sheet and of free cash generation regularly with particular reference to the potential uses of the group's cash resources. In the light of the current challenging trading conditions and the prospects of the Company in the longer term, the board believes it is appropriate to retain enough cash to give the Company the flexibility to continue to invest in product development in the event of the industry downturn being sustained. It does not, therefore, recommend payment of a final dividend for the 12 months ended 31 December 2002.

Tim Score Chief Financial Officer

Selected financial data/UK GAAP

	2002 £000	2001 £000*	2000 £000*	1999 £000*	1998 £000*
Turnover	**150,922**	146,274	100,730	62,120	42,268
Cost of sales	**(13,185)**	(17,289)	(11,647)	(9,803)	(8,316)
Gross profit	**137,737**	128,985	89,083	52,317	33,952
Total operating expenses	**(96,608)**	(83,203)	(57,927)	(35,794)	(25,638)
Group operating profit	**41,129**	45,782	31,156	16,523	8,314
Share of loss of associated undertaking	**–**	–	(85)	–	(71)
Total operating profit	**41,129**	45,782	31,071	16,523	8,243
Net gain on disposals of trade investments	**–**	314	–	–	–
Gain on part disposal of associated undertaking	**–**	–	512	–	–
Interest receivable, net	**4,373**	4,470	3,912	2,266	1,911
Profit on ordinary activities before taxation	**45,502**	50,566	35,495	18,789	10,154
Tax on profit on ordinary activities	**(13,031)**	(15,874)	(6,007)	(261)	(3,371)
Profit on ordinary activities after taxation	**32,471**	34,692	29,488	18,528	6,783
Equity minority interest	**(232)**	(303)	(192)	(64)	(8)
Profit attributable to shareholders	**32,239**	34,389	29,296	18,464	6,775
Dividends	**–**	–	–	–	(4,000)
Retained profit for the financial year	**32,239**	34,389	29,296	18,464	2,775
Capital expenditure	**15,616**	17,349	11,842	5,900	6,402
Cash and short-term investments	**130,304**	104,467	75,266	51,804	39,591
Shareholders' funds	**174,306**	138,111	102,150	69,510	49,718
Employees at end of year (number)	**721**	722	619	443	354

* The prior years' figures have been restated solely as a result of the adoption of Financial Reporting Standard (FRS) 19, "Deferred taxation" (see note 18).

Corporate governance/UK GAAP

Compliance with the Combined Code
The group complies, and complied throughout 2002, with the Combined Code appended to the Listing Rules of the Financial Services Authority.

Composition and operation of the board
The board comprises six executive directors and four independent non-executive directors. The executive directors are the Chairman, Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Technology Officer and Executive Vice President of Marketing. 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 group 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 group's technology and the practices of major US-based technology companies.

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 group. The executive committee, which meets monthly, comprises the executive directors, the directors of ARM Limited, 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 external 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 requirement to maintain an effective system of internal controls. The current audit committee comprises Peter Cawdron (Chairman), Doug Dunn and John Scarisbrick.

In addition to considering and making recommendations to the board in respect of the appointment, remuneration and resignation or dismissal of the group's auditors, the committee also keeps under review the independence and objectivity of the group's external 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 has discussed with the external auditors their independence, and has received and reviewed written disclosures from the external auditors, as required by the Auditing Standards Board's Statement of Auditing Standard No. 610: "Communication of matters to those charged with governance", as well as those required by the US Independence Standards Board's Standard No. 1: "Independence discussions with audit committees". In order to avoid the possibility that the auditors' objectivity and independence could be compromised, the group's tax consulting work is only carried out by the auditors in cases where they are best suited to perform the work, for example, tax compliance and advisory work relating to the audit. In most cases, the group has engaged another independent firm of accountants to perform tax consulting work. The group does not normally award general consulting work to the auditors. However, from time to time, the group will engage the auditors to perform advisory work on matters relating to human resources and royalty audits. In these circumstances, the group will also seek professional advice from another firm of independent consultants or the group's legal advisers.

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, Chief Executive Officer 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. The representatives of the group's auditors meet with the audit committee at least once a year without any executive directors being present.

Remuneration committee
A description of the composition, responsibility and operation of the remuneration committee is set out in the remuneration report on page 23.

Nominations committee

The nominations committee has responsibility for proposing to the board any new appointments of both executive and non-executive directors and makes recommendations to the board on board composition and balance. It is chaired by the 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.

At the beginning of 2002, a risk review team was set up comprising members from different disciplines across the group. It includes members from the board and the executive committee as well as Business Unit Managers and Functional Managers. The team meets four times a year and reports to the board once a year. The team is responsible for identifying and evaluating risks which may impact the group's strategic and business objectives and monitoring progress of actions designed to mitigate the risks. In addition, there is a series of interconnected meetings that span the group from a detailed weekly meeting chaired by the Chief Operating Officer to the main board meetings of the group. Each week a business review meeting is held, the purpose of which is to monitor and control all main business activities, sales forecasts and other matters requiring approval that have arisen within the week. Each month an operations meeting, chaired by the Chief Operating Officer and attended by managers representing different functions across the group, is held to review key performance indicators such as revenues, orders booked, costs, product and project delivery dates and levels of defects found in products in development. Once a quarter, the annual operational plans for the different disciplines across the group are reviewed at the operations meeting. The outputs of the weekly business review meeting and the monthly operations meeting are reviewed by the executive committee which, in turn, raises relevant issues with the main board of the group. 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. It does, however, have an operational internal audit function that audits the group's business and product/project management processes, which are documented, maintained and continuously improved, for both effectiveness and efficiency. In addition, these processes are audited externally by independent auditors for compliance with ISO 9001:2000.

Corporate social and ethical policies

While the group 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 Chief Financial Officer takes responsibility for matters relating to corporate social and ethical policies and these matters are considered at board level. A more comprehensive corporate social responsibility report is available on the group's website. In 2003, there are plans for the group's website to include a section dedicated to corporate social, ethical and environmental issues. The group joined the Institute of Business Ethics in 2000 and, following a process of independent verification, the group received confirmation of its admittance to the Good Corporation Network in August 2001. This qualification assures that the group 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. Each year, the group must pass an annual assessment conducted by an independent verifier that looks at the existence and effectiveness of management practices covered by the 21-point charter. During 2002, the group successfully retained its membership of the Good Corporation Network. As a company whose primary business is the licensing of intellectual property, employees are highly valued and their rights and dignity are respected. The group strives for equal opportunities for all its employees and does not tolerate any harassment of or discrimination against its staff. The group 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 activities. The group's staff makes use of computer-aided design tools to generate intellectual property. This involves neither hazardous substances nor complex waste emissions. The Ethical Investment Research Service, EIRIS, grades the group as a "low impact" business in environmental terms. 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 were started during 2001 and have continued in 2002. The group's environmental policy is published on the group's website. An environmental 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.

The group has continued to compile baseline data on energy use, including estimates for both international business travel and transport to, and from, work. The data for 2002 is published in the group's corporate social responsibility report on the group's website. 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 facilitates greener commuting, and the extensive provision of conference telephone and video conferencing equipment offers 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. In 2002, the group decided not to send traditional Christmas cards to its customers, suppliers and business associates. Instead, the group has sent Christmas cards via electronic mail and has made donations to several charities. The group has a rolling programme of environmental improvements to its offices which include the introduction of an aluminium can recycling scheme in the group's offices in Cambridge in 2002, 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 group 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 and part of the group's website is dedicated to providing investor relations information. At present, around 20 analysts write research reports on the group. The group 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 group'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 group's website. The board actively encourages participation at the Annual General Meeting, scheduled for 15 April 2003, which is the principal forum for dialogue with private shareholders. A presentation will be made outlining recent developments in the business and an open question-and-answer session will follow to enable shareholders to ask questions about the business in general.

By order of the board

Tim Score Company Secretary

Directors' report/UK GAAP

The directors present their annual report and audited financial statements for the year ended 31 December 2002.

Principal activities and review of business

The principal activities of the group 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 serve its customers better, the group has sales offices around the world. These include six offices in the US and offices in Shanghai, PR China; 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 US. A review of business is set out in the Chairman's statement on pages 4 and 5, the Chief Executive Officer's review on pages 6 and 7, the review of operations on pages 8 to 13, and the financial review on pages 16 and 17.

Future developments

The group'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. 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.

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.

Dividends

With the exception of the dividend paid at the time of its initial public offering in April 1998, the group has never paid nor declared any dividends on its shares in line with a number of its peer companies in the high technology sector in the US. Although the policy will be kept under review, the directors envisage making use of the group's cash resources to make strategic investments in the future in situations where the group can broaden its product portfolio and the potential for furthering ARM core-based design wins is improved significantly. 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 2003 include the development of additional versions of the ARM11 core and platform, first implementations of ARM's intelligent energy management technology, additions to the PrimeXsys range of system IP platforms, research into future microprocessor architectures, multi-processing solutions and enhanced application software and development tool products.

The group incurred research and development costs of £48.7 million in 2002, compared with £38.9 million in 2001, which have been charged to the profit and loss account.

Donations

The group made charitable donations of £27,939 (2001: £71,027) during the year. Priorities are given to organisations that are local to the group's offices, promote education and support the wider understanding of science, mathematics and information technology. The group does not make any political donations.

Directors in the year

The following served as directors of the group during the year ended 31 December 2002.

Sir Robin Saxby KBE (Chairman)
Warren East (Chief Executive Officer)
Jonathan Brooks (Chief Financial Officer) resigned 28 March 2002
Tim Score (Chief Financial Officer) appointed 1 March 2002
Tudor Brown (Chief Operating Officer)
Peter Magowan (Executive Vice President, Business Development) resigned 16 August 2002
Michael Muller (Chief Technology Officer)
Mike Inglis (Executive Vice President, Marketing) appointed 14 August 2002
Peter Cawdron (independent non-executive)
Doug Dunn OBE (independent non-executive)
John Scarisbrick (independent non-executive)
Lawrence Tesler (independent non-executive)

During 2002 Doug Dunn was the senior independent non-executive director.

Election of directors

In accordance with the group's articles of association, Peter Cawdron will retire by rotation at the group's Annual General Meeting and will seek re-election at that meeting. See page 14 for his biography. 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, Mike Inglis, who was appointed during the year, will submit himself for election at the group's Annual General Meeting. See page 14 for his biography.

Directors' shareholdings in the group

The interests of the directors in the group'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 26.

Substantial shareholdings

The directors are aware of the following substantial interests in the issued share capital of the group as at 17 February 2003:

	Percentage of issued ordinary share capital
Capital Group Companies	16.0%
Morgan Stanley Securities	6.3%
Legal and General Investment Management	3.7%
Fidelity Investment Management	3.6%
Deutsche Asset Management	3.2%

Save for the above, the group has not been notified, as at 17 February 2003, of any material interest of 3% or more or any non-material interest exceeding 10% of the issued share capital of the group.

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 group 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 group 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. An ARM consultation forum was set up in the group's UK offices, which consists of over 400 employees, during 2002 to provide a forum for employees and management to consult and communicate on issues and ideas. Furthermore, employee share ownership is encouraged and all staff are able to participate in one of the group'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 30 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 2002 was 19 days for the group (2001: 11 days) and nil days for the Company in both years.

Annual General Meeting

The Annual General Meeting will be held at the group's offices in Cambridge, UK, on 15 April 2003 at 2pm. A presentation will be made at this meeting outlining recent developments in the business. The group 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.

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 24 January 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors to fill the casual vacancy. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the group will be proposed at the Annual General Meeting.

Notice of the Annual General Meeting is set out in the circular to shareholders accompanying this annual report.

By order of the board

Tim Score Company Secretary

Remuneration committee

The remuneration committee has responsibility for determining and agreeing with the board, within agreed terms of reference, the group's policy for the remuneration of the executive directors and the individual remuneration packages for the executive directors including basic salary and annual bonuses, the level and terms of grant of options and awards, and the terms of any performance conditions to apply to the exercise of such rights, pension rights and any compensation payments. Where the remuneration committee considers it appropriate the committee will also make recommendations in relation to the remuneration of senior management. The committee also liaises with the board in relation to the preparation of the board's annual report to shareholders on the group's policy on the remuneration of executive directors and in particular the directors' remuneration report, as required by the Companies Act 1985 (as amended), the Combined Code and the Listing Rules of the UK Listing Authority. 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. Given their diverse experience, the four independent non-executive directors are able to offer a balanced view with respect to remuneration issues for the group. The committee has access to professional advice from outside advisers, generally appointed by the Executive Vice President Human Resources, in the furtherance of its duties and makes use of this. During 2002, Linklaters, Watson Wyatt, PricewaterhouseCoopers and the Executive Vice President Human Resources have provided advice or services to the committee. PricewaterhouseCoopers also provided services as the group's auditors. Linklaters provided other legal services to the group. Watson Wyatt did not provide any other services to the group during this period. The Chairman, Chief Executive Officer and Executive Vice President Human Resources will normally attend these meetings. No director is involved in deciding his or her own remuneration.

Remuneration policy

The remuneration committee in its deliberations on the remuneration policy for the group's directors seeks to give full consideration to the Combined Code including the provisions set out in Schedule A to that code. The committee also monitors developments in the accounting for equity-based remuneration on an ongoing basis.

The group 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 their performance and align with the objectives of the group and comprise a mix of performance-related and non-performance-related remuneration. The committee believes that a director's total remuneration should seek to recognise his or her worth in the external market.

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. Currently, variable remuneration consists of two fundamental elements: annual cash bonus and discretionary share options. Both of these incentives are performance-related and as a result more than half of each executive director's remuneration is targeted to be performance linked. Following a review of the group's variable remuneration structure, the remuneration committee concluded that, in order to align better the interests of executive directors with those of shareholders, and to ensure that these key individuals are appropriately incentivised to remain with the group, a higher proportion of executive directors' remuneration should focus on longer-term objectives. As a result, a new policy has been adopted. The remuneration committee intends to introduce a shareholding guideline in accordance with that set out in the Notice of Annual General Meeting.

At the heart of the new policy is a proposal to introduce a long-term incentive plan providing for the annual grant of "performance shares" – a right to receive shares, subject to the group's performance. The group has consulted with its major shareholders and appropriate institutional bodies such as the Association of British Insurers regarding the proposed long-term incentive plan, which is being put to shareholders for approval at this year's Annual General Meeting.

It is also proposed to establish, subject to shareholder approval at the Annual General Meeting, an Inland Revenue approved share incentive plan, as a new element of the group's "all employee" share incentive arrangements. Details of the proposed share incentive plan and the long-term incentive plan are set out in the circular to shareholders accompanying this annual report.

Incentive arrangements

The remuneration committee aims to ensure that individuals are fairly rewarded for their contribution to the success of the group. There is a strong bonus element to executives' remuneration of up to 50% of basic pay. The group operates an annual cash bonus scheme. Bonuses are principally tied to the achievement of the group's financial results, with 50% bonus being awarded if all targets are met. There are three main targets, namely sales, profit growth and forward orders generated for future periods, representing bonus opportunities of 15%, 20% and 15% of base salary respectively. A range of possible outcomes for sales, profit and forward orders generated for future periods is agreed at the beginning of each financial year. If the group's results exceed the minimum levels of each of the agreed targets, bonuses will be payable on a linear basis between the minimum and the maximum of the agreed range. No bonuses are payable in respect of 2002 whilst bonuses of 32% were paid to executive directors for 2001.

A deferred bonus scheme was introduced for executive directors in 2001. This enables executive directors to defer up to 100% of their annual bonus for a period of up to three years during which time the amount of bonus deferred is increased by 33% per annum. It is intended to discontinue this scheme. Existing deferrals will, however, be unaffected.

The group operates a number of share option plans and employees (excluding executive directors) can generally 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. Discretionary options (under the Approved, Unapproved and Incentive Stock Option 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. Share options issued to executive directors prior to their appointment to the board of the group do not have performance conditions attached to them. However, discretionary options issued to executive directors after their appointment to the board of the group will have performance conditions attached to them. The executive directors do not currently receive options under the Approved Scheme and Incentive Stock Option Scheme. Under the Unapproved Scheme, share options with a value of up to five times base salary may be issued on the executive director joining the group. In addition, discretionary options with a value of up to two times base salary may be issued each year. These discretionary options will vest after seven years, but may vest after three years from grant if the performance condition is satisfied. For options granted before January 2003 the performance condition is that the group must achieve an average real EPS growth of at least 33.1% (ie. 33.1% greater than the percentage increase (if any) in the Retail Price Index) over a performance period of three years commencing from the start of the financial year in which the options are granted (the "performance period"). The remuneration committee, as part of its review of the group's variable remuneration structure, reviewed the performance condition for discretionary options to ensure that it remained an effective tool for attracting, motivating and retaining executives, and was in keeping with the guidelines of the Association of British Insurers. As a result of this review, it was decided to change the performance condition from a "cliff-edge" to a "sliding-scale" target for new option grants from January 2003. Under the performance condition, 50% of the shares under option will vest after three years if the group achieves an average real EPS growth of 9.3% over the performance period. If an average real EPS growth of at least 33.1% is achieved over the performance period, 100% of the shares under option will vest after three years. Where the average real EPS growth over the performance period is between 9.3% and 33.1%, the number of shares which vest after three years increases on a straight-line basis. Although the performance targets are amongst the most demanding of those set by companies included in the FTSE 350 index, the remuneration committee considers this to be appropriate as the group is operating in the technology market which is still expected to grow significantly in the long term.

Pensions

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 basic salary (25% in the case of the 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. The service contracts also terminate when executive directors reach age 65. These agreements provide for each of the directors to provide services to the group 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.

The dates of the service contracts of each person who served as a director during the financial year are as follows:

Director	Date
Sir Robin Saxby	31 January 1996
Warren East	29 January 2001
Tim Score	1 March 2002
Tudor Brown	3 April 1996
Michael Muller	31 January 1996
Mike Inglis	17 July 2002
Jonathan Brooks	2 February 1996
Peter Magowan	29 January 2001

Where notice is served to terminate the appointment, whether by the group or the executive director, the group in its absolute discretion shall be entitled to terminate the appointment by paying to the executive director his salary in lieu of any required period of notice.

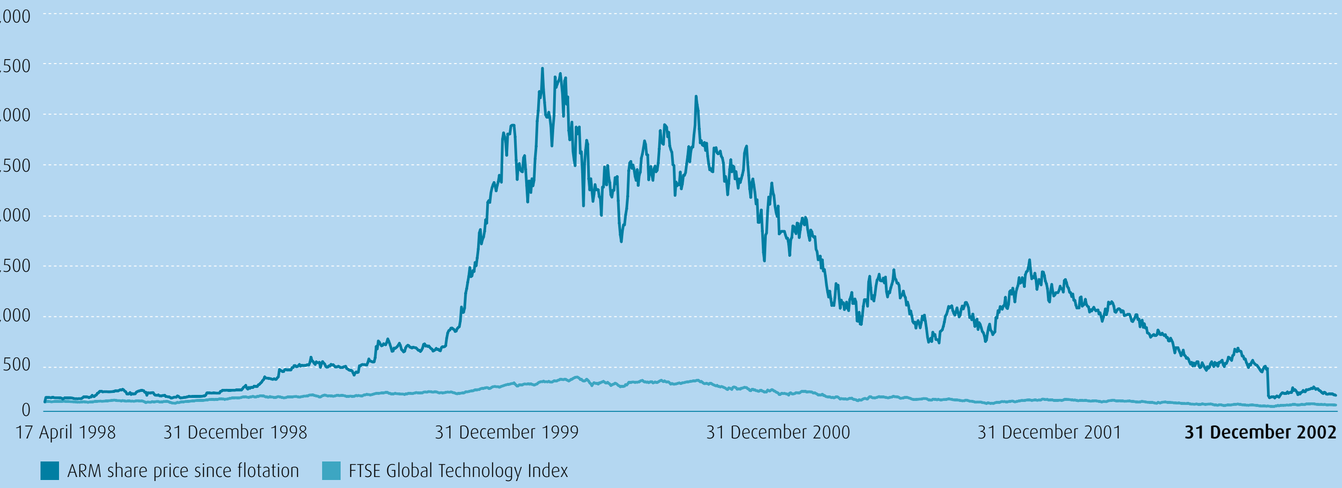
Non-executive directors

During 2002, each non-executive director received a total fee of £24,000 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, which is around 10 to 15 working days a year. The group believes that Peter Cawdron, an independent non-executive director, who currently holds more than five directorships, is able to devote the agreed amount of time to the group's activities. The remuneration of the non-executive directors is set by the board of the group and their term of appointment is three years. Non-executive directors do not have service contracts. Non-executive directors are not eligible to participate in bonus or share incentive arrangements and their service does not qualify for pension purposes or other benefits. No element of their fees is performance-related.

Performance graphs

A performance graph showing the group's total shareholder return (TSR) together with the TSR for the FTSE Global Technology Index of 50 companies from 17 April 1998, the date when the group's shares first commenced trading on the London Stock Exchange and Nasdaq, is shown below. The TSR is being calculated in accordance with the Directors' Remuneration Report Regulations 2002. The TSR for the group's shares was 67% over this period compared with -30% for the FTSE Global Technology Index for the same period.

TSR on £100 of ARM shares vs FTSE Global Technology Index **(£ sterling)**



The directors consider the FTSE Global Technology Index to be an appropriate choice as the Index contains companies from the US, Asia and Europe, which reflects the global environment in which the group operates. In addition, the Index includes many companies that are currently the group's customers as well as companies which utilise ARM technology in their end products.

Directors' shareholdings in the group

The directors' beneficial interests in the group's ordinary shares of 0.05 pence, which excludes interests under the group's share option schemes, are set out below.

Director	**31 December 2002 Number**	31 December 2001 Number
R Saxby	**25,632,860**	26,132,860
W East	**174,920**	154,920
T Score*	**10,000**	–
T Brown	**1,496,460**	1,496,460
M Muller	**1,891,860**	1,891,860
M Inglis*	**10,000**	–
D Dunn	**48,000**	48,000
P Cawdron	**98,000**	98,000
J Scarisbrick	**10,800**	10,800
L Tesler	**111,000**	90,000

* Comparative figures for T Score's and M Inglis' 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 1,796,754 ordinary shares respectively at 31 December 2002 and 5,000,000 and 2,017,599 shares respectively at 31 December 2001. There have been no changes in directors' interests in the group's shares to the date of approval of the remuneration report.

Options over shares in the group

Details of discretionary options beneficially held by directors are set out below:

Director	As at 1 January 2002 Number	Granted Number	Exercised Number	Lapsed Number	**As at 31 December 2002 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***
		100,000	–	–	**100,000**	2.465	19/04/05	18/04/09***
	227,058	100,000	–	–	**327,058**			
T Score††	–	206,896	–	–	**206,896**	2.465	19/04/05	18/04/09***
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†
		50,000	–	–	**50,000**	2.465	19/04/05	18/04/09***
	190,000	50,000	–	–	**240,000**			
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†
	–	50,000	–	–	**50,000**	2.465	19/04/05	18/04/09***
	186,351	50,000	–	–	**236,351**			
M Inglis††	223,515		–	–	**223,515**	2.1475	27/05/03	26/05/09†
J Brooks	140,000	–	–	140,000	**–**	1.224	11/3/02	10/03/06**
	4,874	–	–	4,874	**–**	6.155	22/5/03	21/05/10*
	20,126	–	–	20,126	**–**	6.155	22/5/01	21/05/07†
	165,000	–	–	165,000	**–**			
P Magowan	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***
		50,000	–	50,000	**–**	2.465	19/04/05	18/04/09***
	221,274	50,000	140,000	131,274	–			

* Denotes share options issued under the group's approved share option scheme.
** Denotes share options issued under the group's unapproved share option scheme.
*** Denotes share options issued under the group's unapproved share option scheme with performance conditions attached.
† Denotes share options issued under the group's unapproved share option scheme which are exercisable as follows:
25% maximum from first anniversary, 50% maximum from second anniversary, 75% maximum from third anniversary, 100% maximum on fourth anniversary.
†† Denotes number of share options held by T Score and M Inglis on their date of appointment.

Share options with performance conditions attached normally vest after seven years. If, however, the group achieves an average EPS growth of at least 33.1% greater than the percentage increase (if any) in the Retail Price Index over a period of three years commencing from the start of the financial year in which the options are granted, then the options will be exercisable after three years from grant. EPS is defined as the Group's fully diluted earnings per ordinary share. The method of calculating EPS will be adjusted if necessary so that the calculation of the EPS for each relevant financial period of the Group is broadly comparable with that for any other financial period of the Group taken for the purposes of the performance condition.

On 30 January 2003, discretionary share options were granted to the following executive directors: Warren East 914,285; Tim Score 777,142; Tudor Brown 731,428; Michael Muller 731,428; and Mike Inglis 731,428. The exercise price is 43.75 pence.

These options vest after seven years, but may vest after three years if the following performance condition is satisfied. Where the Group achieves an average EPS growth of at least 9.3% greater than the percentage increase (if any) in the Retail Prices Index over a performance period of three years commencing from the start of the financial year in which options are granted, then 50% of the shares under option will vest three years from grant. For an average EPS growth of at least 33.1% greater than the percentage increase (if any) in the Retail Prices Index over the performance period, 100% of the shares under option will vest after three years from grant. Where the average EPS growth is between 9.3% and 33.1% greater than the percentage increase (if any) in the Retail Prices Index over the performance period, vesting increases on a straight-line basis.

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

Director	As at 1 January 2002 Number	Granted Number	Exercised Number	Lapsed Number	**As at 31 December 2002 Number**	Exercise price £	Earliest date of exercise	Expiry date
R Saxby	3,157	–	–	–	**3,157**	3.0685	01/07/04	31/12/04
W East	3,157	–	–	–	**3,157**	3.0685	01/07/04	31/12/04
T Brown	3,157	–	–	–	**3,157**	3.0685	01/07/04	31/12/04
M Inglis*	3,626	–	–	–	**3,626**	1.8254	01/07/07	31/12/07
P Magowan	3,157	–	–	3,157	**–**	3.0685	01/07/04	31/12/04

* Denotes number of share options held by M Inglis on the date of appointment as director.

The gains made by Peter Magowan on the exercise of share options were £58,240 (2001: £1,988,400). The share price on the date of exercise was £1.64.

Except as described above, there have been no changes in directors' interests under the Group's share option schemes since the end of the 2002 financial year up to the date of approval of the remuneration report.

The Group's register of directors' interests contains full details of directors' shareholdings and options to subscribe.

Share prices

The market value of the shares of the Group as at 31 December 2002 was 48 pence. The closing mid-price ranged from 40.5 pence to 385.75 pence during the year.

Deferred bonus scheme

Warren East elected to participate in the deferred bonus scheme in 2001 and deferred £12,680, being one-third of his bonus, for three years. Provided Warren East remains with the Group until 31 December 2004, the bonus payable on that date will be £25,360 representing an increase of 100% plus 6% interest per annum on the deferred amount.

Directors' emoluments

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

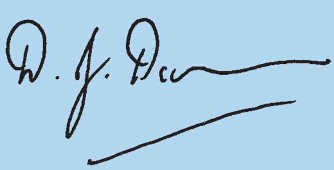
Director	Fees £	Basic salary £	Benefits** £	Bonus payments £	Subtotal £	Pension contributions £	**Total 2002 £**	Total 2001 £
Executive								
R Saxby	–	200,000	11,559	–	211,559	24,188	**235,747**	370,095
W East	–	180,000	11,606	–	191,606	9,675	**201,281**	179,022
J Brooks*	–	33,410	2,446	–	35,856	2,923	**38,779**	227,751
T Brown	–	145,000	11,606	–	156,606	9,675	**166,281**	61,648
P Magowan*	–	87,208	7,297	–	94,505	6,043	**100,548**	179,022
M Muller	–	145,000	11,606	–	156,606	9,675	**166,281**	56,131
T Score*	–	141,667	10,602	–	152,269	7,290	**159,559**	–
M Inglis*	–	60,645	4,404	–	65,049	3,684	**68,733**	–
J Urquhart*	–	–	–	–	–	–	**–**	139,419
Total	–	992,930	71,126	–	1,064,056	73,153	**1,137,209**	1,213,088
Non-executive								
P Cawdron	24,000	–	–	–	24,000	–	**24,000**	22,000
D Dunn	24,000	–	–	–	24,000	–	**24,000**	22,000
J Scarisbrick	24,000	–	–	–	24,000	–	**24,000**	7,333
L Tesler	24,000	–	–	–	24,000	–	**24,000**	22,000
Total	96,000	–	–	–	96,000	–	**96,000**	73,333
Total	96,000	992,930	71,126	–	1,160,056	73,153	**1,233,209**	1,286,421

* For T Score and M Inglis, salaries shown are from date of appointment. For J Brooks and P Magowan, salaries shown are up to their date of resignation from the board. For J Urquhart, the comparative figure shows the salary up to the date of his resignation from the board on 12 October 2001.

** All the executive directors receive family BUPA and annual travel insurance as part of their benefits in kind. In addition, T Score has the use of a company car and R Saxby, W East, T Brown, M Muller and M Inglis receive a car allowance.

Jamie Urquhart, a former director of the Group who resigned from the board on 12 October 2001 but remained an employee of the group, took part in a group-wide redundancy programme and received redundancy payments amounting to £69,675 on leaving the group during 2002.

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.



Doug Dunn OBE Chairman of the Remuneration Committee

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 group and the Company, 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 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 group'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.

Independent auditors' report to the members of ARM Holdings plc/UK GAAP

We have audited the financial statements on pages 32 to 55 which have been prepared under the historical cost convention and the accounting policies set out on pages 36 to 38. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985, on pages 27 to 29, contained in the directors' remuneration report ("the auditable part").

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration 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 and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the group's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the directors' remuneration report have been 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 group 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 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 statement, the Chief Executive Officer's review of operations, directors and advisers, financial review, corporate governance, the directors' report and the unaudited part of the remuneration report.

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 of the Financial Services Authority, 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 group's or Company'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 and the auditable part of the directors' remuneration report. 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 group'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 and the auditable part of the directors' remuneration report 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 group and the Company at 31 December 2002 and of the profit and cash flows of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP Chartered Accountants and Registered Auditors
Cambridge
28 February 2003

Consolidated profit and loss account/UK GAAP
For the year ended 31 December 2002

	Notes	2002 £000	2002 £000	2001 £000*
Turnover	2		**150,922**	146,274
Cost of sales			**(13,185)**	(17,289)
Gross profit			**137,737**	128,985
Operating expenses				
Research and development		**(48,674)**		(38,920)
Exceptional research and development	5	**(1,327)**		–
			(50,001)	
Sales and marketing		**(24,516)**		(21,448)
Exceptional sales and marketing	5	**(320)**		–
			(24,836)	
Administrative expenses		**(21,458)**		(22,835)
Exceptional administrative expenses	5	**(313)**		–
			(21,771)	
Total operating expenses			**(96,608)**	(83,203)
Operating profit			**41,129**	45,782
Net gain on disposal of fixed asset trade investments			**–**	314
Interest receivable and similar income			**4,373**	4,470
Profit on ordinary activities before taxation	2, 5		**45,502**	50,566
Tax on profit on ordinary activities	6		**(13,031)**	(15,874)
Profit on ordinary activities after taxation			**32,471**	34,692
Equity minority interest	20		**(232)**	(303)
Retained profit for the financial year	18		**32,239**	34,389
Earnings per 0.05 pence ordinary share	8			
Basic			**3.2p**	3.4p
Diluted			**3.2p**	3.4p

* The prior year's figures have been restated solely as a result of the adoption of Financial Reporting Standard (FRS) 19, "Deferred taxation" (see note 18).

All activities relate to continuing operations.

Statement of group total recognised gains and losses/UK GAAP

	Notes	2002 £000	2001 £000*
Profit for the financial year		**32,239**	34,389
Foreign exchange difference on consolidation	18, 19	**(807)**	14
Total recognised gains for the year		**31,432**	34,403
Prior year adjustment	18	**584**	
Total gains recognised since last annual report		**32,016**	

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

Consolidated balance sheet/UK GAAP
As at 31 December 2002

	Notes	2002 £000	2001 £000*
Fixed assets			
Intangible assets	9	**9,153**	12,427
Tangible assets	10	**25,721**	22,668
Investments	11	**6,395**	5,943
		41,269	41,038
Current assets			
Stocks	12	**1,515**	581
Debtors	13	**33,558**	32,204
Short-term investments	15	**126,013**	94,376
Cash at bank and in hand	15	**4,291**	10,091
		165,377	137,252
Creditors: amounts falling due within one year	14	**(31,483)**	(39,360)
Net current assets		**133,894**	97,892
Total assets less current liabilities		**175,163**	138,930
Provisions for liabilities and charges	16	**(16)**	(210)
Net assets	2	**175,147**	138,720
Capital and reserves			
Called-up share capital	17	**511**	507
Share premium account	18	**80,883**	76,124
Other reserves	18	**(663)**	144
Profit and loss account	18	**93,575**	61,336
Equity shareholders' funds	19	**174,306**	138,111
Minority interest – equity	20	**841**	609
Capital employed		**175,147**	138,720

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

The financial statements on pages 32 to 55 were approved by the board of directors on 28 February 2003 and were signed on its behalf by:

Sir Robin Saxby Director

Company balance sheet/UK GAAP
As at 31 December 2002

	Notes	2002 £000	2001 £000
Fixed assets			
Investments	11	**2,166**	2,388
Current assets			
Debtors	13	**35,340**	35,708
Short-term investments		**48,381**	42,324
Cash at bank and in hand		**50**	18
		83,771	78,050
Creditors: amounts falling due within one year	14	**(219)**	(255)
Net current assets		**83,552**	77,795
Total assets less current liabilities		**85,718**	80,183
Net assets		**85,718**	80,183
Capital and reserves			
Called-up share capital	17	**511**	507
Share premium account	18	**80,883**	76,124
Profit and loss account	18	**4,324**	3,552
Equity shareholders' funds		**85,718**	80,183

The financial statements on pages 32 to 55 were approved by the board of directors on 28 February 2003 and were signed on its behalf by:

Sir Robin Saxby Director

Consolidated cash flow statement/UK GAAP
For the year ended 31 December 2002

	Notes	2002 £000	2001 £000
Net cash inflow from operating activities	21	**52,087**	57,001
Returns on investments and servicing of finance			
Interest received		**4,187**	4,604
Net cash inflow from returns on investments and servicing of finance		**4,187**	4,604
Taxation			
Withholding tax paid		**(5,011)**	(2,149)
UK corporation tax paid		**(10,592)**	(7,129)
Overseas tax paid		**(1,155)**	(365)
Tax paid		**(16,758)**	(9,643)
Capital expenditure and financial investment			
Purchase of fixed asset investments		**(1,500)**	–
Sale of fixed asset investments		**–**	1,936
Purchase of tangible fixed assets		**(15,616)**	(17,349)
Sale of tangible fixed assets		**35**	71
Purchase of intangible fixed assets		**(855)**	(8,568)
Proceeds received by QUEST on allocation of own shares held		**222**	958
Net cash outflow for capital expenditure and financial investment		**(17,714)**	(22,952)
Acquisitions and disposals			
Purchase of assets and trade	24	**–**	(1,351)
Net cash outflow from acquisitions and disposals		**–**	(1,351)
Net cash inflow before management of liquid resources and financing		**21,802**	27,659
Management of liquid resources			
Purchase of short-term investments	23	**(31,637)**	(24,893)
Financing			
Issue of shares		**4,763**	1,558
Net cash inflow from financing		**4,763**	1,558
(Decrease)/increase in cash	23	**(5,072)**	4,324

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 UK. 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", is set out below together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

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 2002. Intra-group transactions and profits are eliminated fully on consolidation.

Changes in accounting policies The group has adopted FRS 19, "Deferred taxation", in these financial statements. The adoption of this standard represents a change in accounting policy and the comparative figures have been restated accordingly (see note 18).

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 them. 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, PR China 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.

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. Revenue from per-use licences is recognised when the product is accepted by the customer.

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.

1 Principal accounting policies continued

Agreements including rights to unspecified products are accounted for using subscription accounting, revenue from the arrangement being recognised 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 licence 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 recognised 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 licence (such as off-the-shelf software) are recognised 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 recognised as services are performed and collectability is probable.

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

Royalty revenues are earned on sales by the group's customers of products containing ARM technology. Revenues are recognised 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 recognised 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 recognised on a percentage-to-completion basis as milestones are achieved. Consulting costs are recognised when incurred.

As disclosed above, in accordance with FRS 18, "Accounting policies", the group makes significant estimates in applying its revenue recognition policies. In particular, as discussed in detail above, estimates are made in relation to the use of the percentage-to-completion accounting method, which requires that the extent of progress toward completion of contracts may be anticipated with reasonable certainty. The use of the percentage-to-completion method is itself based on the assumption that, at the outset of licence agreements, customer acceptance is not uncertain. In addition, when allocating revenue to various elements of multi-element arrangements, it is assumed that the fair value of each element is reflected by its price when sold separately. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent with the application of the revenue recognition policies affect the amounts reported in the financial statements. If different assumptions were used, it is possible that different amounts would be reported in the financial statements.

Deferred taxation Provision is made for deferred taxation, using full provision accounting when an event has taken place by the balance sheet date which gives rise to an increased or reduced tax liability in the future in accordance with FRS 19, "Deferred taxation". Deferred tax assets and liabilities are not discounted.

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 (UITF) 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 UITF 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.

1 Principal accounting policies continued

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

Provision for doubtful debts Provision is made for doubtful debts following reviews of individual customer circumstances by management.

2 Segmental analysis

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

Turnover by destination

	2002 £000	2001 £000
Europe	26,731	27,103
US	67,086	72,271
Asia Pacific	57,105	46,900
	150,922	146,274

Turnover by origin

	2002			2001		
	Total sales £000	Inter-segment sales £000	External sales £000	Total sales £000	Inter-segment sales £000	External sales £000
Europe	148,578	(10,831)	137,747	142,614	(11,478)	131,136
US	29,041	(21,753)	7,288	27,949	(19,518)	8,431
Asia Pacific	9,415	(3,528)	5,887	9,579	(2,872)	6,707
	187,034	(36,112)	150,922	180,142	(33,868)	146,274

Profit before taxation, by origin

	2002				2001
	Operating profit pre exceptional item £000	Exceptional item £000	Interest £000	Profit before tax £000	Profit before tax £000
Europe	38,324	(1,509)	4,162	40,977	46,502
US	1,970	(412)	15	1,573	957
Asia Pacific	2,795	(39)	196	2,952	3,107
	43,089	(1,960)	4,373	45,502	50,566

Net assets

	2002 £000	2001* £000
Europe	162,038	128,833
US	6,787	5,363
Asia Pacific	6,322	4,524
	175,147	138,720

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

3 Directors' emoluments

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

	2002 £	2001 £
Aggregate emoluments in respect of qualifying services	**1,160,056**	1,222,948
Aggregate gains made on exercise of share options	**58,240**	7,386,530
	1,218,296	8,609,478
Aggregate group pension contributions to money purchase schemes	**73,153**	63,473
	1,291,449	8,672,951

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

	2002 £	2001 £
Emoluments in respect of qualifying services	**211,559**	218,301
Gains made on exercise of share options	**–**	5,097,177
	211,559	5,315,478
Group pension contributions to money purchase schemes	**24,188**	9,450
	235,747	5,324,928

Detailed disclosures of directors' emoluments are shown on page 29. Details of directors' interests in share options are shown on pages 27 and 28.

4 Employee information

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

	2002 Number	2001 Number
By activity:		
Research and development	**437**	409
Administration	**100**	87
Sales and marketing	**212**	182
	749	678

	2002 £000	2001 £000
Staff costs (for the above persons):		
Wages and salaries	**37,732**	37,360
Social security costs	**3,463**	2,989
Other pension costs	**1,894**	1,591
	43,089	41,940

In addition to the above, payments totalling £1,886,000 were made to employees in respect of redundancy.

Of the total pension costs above, £nil (2001: £nil) remained unpaid at the year end.

5 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	2002 £000	2001 £000
Depreciation charge for the year:		
Tangible owned fixed assets	**12,463**	9,327
Amortisation of goodwill	**1,352**	1,979
Amortisation of other intangible assets	**2,777**	1,091
(Profit)/loss on disposal of fixed assets	**(14)**	187
Auditors' remuneration:		
Audit services (Company £5,000 (2001: £5,000))	**152**	146
Non-audit services	**95**	183
Hire of plant and machinery – operating leases	**1,736**	163
Leased buildings – operating leases	**3,463**	2,938

In 2002 non-audit fees were £95,000 (2001: £183,000) and related to tax compliance and advisory work £37,000 (2001: £63,000), interim reviews, SEC-related work and accounting advice £47,000 (2001: £36,000), royalty audits £4,000 (2001: £50,000) and other advisory work £7,000 (2001: £34,000).

Fees to other major firms of accountants for non-audit services amounted to £114,000 (2001: £207,000).

Exceptional items relate to the cost of payments made for redundancy for 98 employees and for related outplacement services. These were all paid during the year.

6 Tax on profit on ordinary activities

	2002 £000	2001 £000*
Current		
UK corporation tax at 30% (2001: 30%)	**12,846**	14,616
Overseas corporation tax	**1,106**	1,013
Under/(over) provision in respect of prior years:		
UK corporation tax	**5**	(114)
Overseas corporation tax	**(68)**	–
	13,889	15,515
Deferred		
UK deferred tax – origination and reversal of timing differences	**(500)**	268
Overseas deferred tax – origination and reversal of timing differences	**(358)**	91
Subtotal	**(858)**	359
	13,031	15,874

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation", with the result that the deferred tax charge for 2001 has increased by £268,000 (see note 18).

The taxation charge for 2002 was reduced by £754,000 (2001: £537,000) in relation to tax losses generated by overseas subsidiaries.

Under legislation introduced with effect from 1 April 2002, the tax charge is affected by the availability of UK research and development tax credits. The tax impact is a reduction in the tax charge for the year of £781,000 (2001: £nil).

6 Tax on profit on ordinary activities continued

The current tax charge for the year is higher than the standard rate of corporation tax in the UK. The differences are explained below:

	2002 £000	2001 £000
Profit on ordinary activities before taxation	**45,502**	50,566
Taxation charge at UK corporation tax rate of 30%	**13,651**	15,170
Effects of:		
Over provision in respect of prior years	**(63)**	(114)
Accelerated capital allowances and other timing differences	**692**	(226)
Permanent differences	**267**	1,143
Higher average tax rates in overseas countries	**(8)**	(17)
Losses utilised during the year	**(650)**	(441)
Current tax charge for the year	**13,889**	15,515

The analysis of the deferred tax asset movement for the group is as follows:

	Deferred tax asset 2002 £000	Deferred tax asset 2001 £000*
At 1 January	**839**	1,198
Credited/(charged) to the profit and loss account	**858**	(359)
At 31 December	**1,697**	839

* The prior year's figures have been restated purely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

The analysis of deferred tax assets for the group is as follows:

	Amount recognised		Amount not recognised	
	2002 £000	2001 £000*	2002 £000	2001 £000*
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	**1,193**	584	**–**	–
Losses carried forward	**–**	–	**544**	1,397
Other	**504**	255	**15**	60
	1,697	839	**559**	1,457

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

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.

No deferred tax asset has been recognised for the amounts unprovided because of the uncertainty of utilising these losses in the future.

The Company has no potential liability for deferred taxation.

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 £772,000 (2001: £972,000).

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 and directors where the exercise price is less than the average 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:

	2002			2001		
	Earnings £000	**Number of shares Thousands**	**Per share amount Pence**	Earnings £000*	Number of shares Thousands	Per share amount Pence*
Basic EPS						
Profit available to ordinary shareholders	**32,239**	**1,012,295**	**3.2p**	34,389	999,742	3.4p
Effect of dilutive securities:						
Options	**–**	**8,465**		–	24,891	
Diluted EPS						
Adjusted earnings	**32,239**	**1,020,760**	**3.2p**	34,389	1,024,633	3.4p

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation", with the result that the earnings for 2001 have decreased by £268,000 and the basic EPS for 2001 has decreased by 0.1 pence.

9 Intangible fixed assets

Group	Patents and licences £000	Goodwill £000	Total £000
Cost			
At 1 January 2002	11,390	5,744	17,134
Additions	855	–	855
At 31 December 2002	**12,245**	**5,744**	**17,989**
Aggregate amortisation			
At 1 January 2002	1,325	3,382	4,707
Charge for the year	2,777	1,352	4,129
At 31 December 2002	**4,102**	**4,734**	**8,836**
Net book value			
At 31 December 2002	**8,143**	**1,010**	**9,153**
At 31 December 2001	10,065	2,362	12,427

The group has patents and licences which are being amortised over three to five years.

Goodwill arising on previous years' acquisitions is being written off over two years in the case of ARM France SAS, and three years in the case of Allant Software Corporation and Noral Micrologics Limited.

The Company does not own any intangible fixed assets.

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 2002	190	75	11,863	34,343	2,819	49,290
Exchange differences	–	–	(94)	(263)	(79)	(436)
Additions	–	–	6,946	8,186	484	15,616
Transfer	–	(75)	75	–	–	–
Disposals	–	–	(27)	(360)	(123)	(510)
At 31 December 2002	**190**	**–**	**18,763**	**41,906**	**3,101**	**63,960**
Aggregate depreciation						
At 1 January 2002	23	–	4,480	20,531	1,588	26,622
Exchange differences	–	–	(64)	(240)	(53)	(357)
Charge for year	10	–	3,683	8,367	403	12,463
Disposals	–	–	(23)	(354)	(112)	(489)
At 31 December 2002	**33**	**–**	**8,076**	**28,304**	**1,826**	**38,239**
Net book value						
At 31 December 2002	**157**	**–**	**10,687**	**13,602**	**1,275**	**25,721**
At 31 December 2001	167	75	7,383	13,812	1,231	22,668

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 2002	–	4,168	2,388	6,556
Additions	1,500	–	–	1,500
Shares allocated to satisfy exercises under SAYE scheme	–	–	(222)	(222)
At 31 December 2002	**1,500**	**4,168**	**2,166**	**7,834**
Amounts written off				
At 1 January 2002	–	613	–	613
Amounts written off during the year	–	826	–	826
At 31 December 2002	**–**	**1,439**	**–**	**1,439**
Net book value				
At 31 December 2002	**1,500**	**2,729**	**2,166**	**6,395**
At 31 December 2001	–	3,555	2,388	5,943

Listed investments During the year the group invested in Superscape plc, a company listed on the London Stock Exchange, taking an 11.99% stake in the company. The cost and market value of this investment as at 31 December 2002 was £1,500,000. The investment was made in order to broaden the scope of the group's collaboration with Superscape plc in the area of 3D technology for wireless devices.

Other investments Included in other investments are the group's less than 1% holding in the share capital of Cambridge Silicon Radio Limited, an intellectual property company which develops Bluetooth solutions, and an investment originally representing 3.5% in the share capital of CoWare, Inc., a company which develops system-on-chip software for a wide range of applications. The group also has a 0.24% investment in the share capital of Palmchip Corporation, a private fabless chip company based in California, and a 1.7% investment in the share capital of Pixim, Inc., also a private fabless chip company based in California.

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

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 UITF 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 2002 and no awards have been made since the trust was created. As at 31 December 2002 and 2001 the trust held 5,000,000 shares (nominal value £2,500) with a market value of £2,400,000 at 31 December 2002 (2001: £17,950,000). 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.

11 Fixed asset investments continued

Investment in own shares held also includes £728,000 relating to 1,796,754 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. During the year, 220,846 (2001: 3,925,400) shares were allocated to satisfy employees' and directors' exercises under the Company's Save As You Earn scheme. The shares held by the QUEST are valued at the lower of the amounts receivable from employees on exercise of their options and the mid-market price at 31 December 2002. The market value of the shares at 31 December 2002 was £862,442 (2001: £7,243,180).

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	Investment in group undertakings £000	Investment in own shares £000	Total £000
Cost and net book value			
At 1 January 2002	–	2,388	2,388
Shares allocated to satisfy exercises under SAYE scheme	–	(222)	(222)
At 31 December 2002	**–**	**2,166**	**2,166**

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%
ARM Consulting (Shanghai) Co. Ltd.	P. R. China	Marketing of RISC-based processors	100%
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	**2002 £000**	2001 £000
Finished goods	**1,515**	581

The Company had no stocks at 31 December 2002 and 2001.

13 Debtors

	Group 2002 £000	Group 2001 £000*	Company 2002 £000	Company 2001 £000
Amounts falling due within one year:				
Trade debtors	**20,516**	24,809	**–**	–
Amounts owed by group undertakings	**–**	–	**35,091**	35,609
Corporation tax	**–**	550	**–**	–
Other debtors	**1,802**	1,308	**–**	–
Deferred tax (see note 6)	**1,697**	839	**–**	–
Prepayments and accrued income	**9,543**	4,698	**249**	99
	33,558	32,204	**35,340**	35,708

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation", with the result that the deferred tax debtor for 2001 has increased by £584,000.

14 Creditors: amounts falling due within one year

	Group 2002 £000	Group 2001 £000	Company 2002 £000	Company 2001 £000
Trade creditors	**4,730**	2,361	**–**	–
Corporation tax	**3,828**	7,054	**190**	232
Other taxation and social security	**824**	784	**–**	–
Other creditors	**1,027**	1,189	**–**	–
Accruals and deferred income	**21,074**	27,972	**29**	23
	31,483	39,360	**219**	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 2002, the group had outstanding forward contracts to sell $54,000,000 (2001: $42,800,000). The group had $33,293,000 (2001: $34,631,000) of trade debtors denominated in US dollars at that date, and US dollar cash balances of $28,645,000 (2001: $22,720,000). Thus 13% (2001: 24%) 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. As the amounts involved are not considered significant, the group does not take out euro forward contracts.

The group, where required, invests 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.

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 2002, the group invested in Superscape plc, a company listed on the London Stock Exchange.

The Company holds investments in four private companies, Pixim, Inc., CoWare, Inc., Palmchip Corporation and Cambridge Silicon Radio Limited, all of which develop products based on ARM technology.

External borrowings The group had no long-term debt at 31 December 2002 (2001: £nil) or during the financial year.

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

Group	2002			2001		
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	89	102,821	102,910	425	85,855	86,280
US dollars	2,452	17,113	19,565	5,590	6,904	12,494
European currencies (other than sterling)	610	2,473	3,083	280	1,617	1,897
Other currencies	1,140	3,606	4,746	3,796	–	3,796
At 31 December	4,291	126,013	130,304	10,091	94,376	104,467
Floating rate	4,291	–	4,291	10,091	–	10,091
Fixed rate	–	126,013	126,013	–	94,376	94,376
At 31 December	4,291	126,013	130,304	10,091	94,376	104,467

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 1.2% and 4.625% (2001: 1.65% and 6.1%). Floating rate cash earns interest based on relevant national LIBID equivalents.

Financial liabilities Provisions for National Insurance and similar taxes of £16,000 (2001: £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 forward contracts is estimated using the settlement rates. The fair value of forward contracts is estimated at £1,061,000 at 31 December 2002 (2001: £355,000). The increase is due to changes in the sterling/US dollar exchange rate in 2002.

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 the group's investments in unlisted companies (carrying value at 31 December 2002: £2,729,000) 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.

Investments in listed companies The fair value of listed investments is determined with reference to prices quoted on the London Stock Exchange at 31 December 2002. On this basis, the fair value of the group's listed investment was equal to its carrying value at 31 December 2002 (2001: no listed investments).

Provisions The carrying amount of £16,000 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 currencies other than their local currency, net of forward contracts. Foreign exchange differences on retranslation of these assets and liabilities are taken to the profit and loss account of the individual companies and the group.

2002	US dollars £000	European currencies £000	Other currencies £000	Total £000
Functional currency of group operation				
Sterling	**(729)**	**1,755**	**(145)**	**881**
Other currencies	**966**	**–**	**–**	**966**
Total	**237**	**1,755**	**(145)**	**1,847**

2001				
Functional currency of group operation				
Sterling	10,522	2,108	47	12,677
Other currencies	60	–	–	60
Total	10,582	2,108	47	12,737

Hedges The group's hedging policy is to hedge currency risk using forward foreign currency contracts for foreign currency debtors and cash. 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 2002	–	–	–	355	–	355
Arising in previous years included in 2002 income	–	–	–	(355)	–	(355)
Gains and losses not included in 2002 income	–	–	–	–	–	–
Arising in 2002	–	–	–	1,061	–	1,061
Gains and losses on hedges at 31 December 2002	–	–	–	1,061	–	1,061
Of which:						
Gains and losses expected to be included in 2003 income	–	–	–	1,061	–	1,061

Gains deferred at 31 December 2002 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 provision is as follows:

	2002 £000	2001 £000
At 1 January	**210**	219
Credited to the profit and loss account	**(194)**	(9)
At 31 December	**16**	210

The provision relates to employer's National Insurance and similar taxes on certain share options provided in accordance with UITF Abstract 25.
The provision fluctuates with movements in share price and the exercise of the share options.

17 Called-up share capital

Company	2002 £000	2001 £000
Authorised		
1,580,000,000 ordinary shares of 0.05 pence each (2001: 1,580,000,000)	**790**	790
Allotted, called-up and fully paid		
1,021,758,000 ordinary shares of 0.05 pence each (2001: 1,014,767,176)	**511**	507

6,990,824 ordinary shares of 0.05 pence each were issued in the year for cash consideration of £4,762,594. 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 2002:

			Period of option	
Date of issue	Ordinary shares of 0.05 pence each Number	Exercise price per share £	Earliest date	Latest date
15 July 1996	320,000	0.02	15 July 1999	14 July 2006
15 July 1996	600,000	0.02	15 July 1999	14 July 2003
5 March 1997	725,500	0.026	5 March 2000	4 March 2007
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	70,000	0.0625	25 June 2000	24 June 2004
1 October 1997	150,000	0.0625	1 October 2000	30 September 2004
24 December 1997	230,000	0.0625	24 December 2000	23 December 2004
7 March 1998	660,000	0.1125	7 March 2001	6 March 2008
7 March 1998	55,036	0.1125	7 March 1999	6 March 2003**
17 April 1998*	179,400	0.2445	1 June 2003	30 November 2003
8 June 1998	134,309	0.3875	8 June 1999	7 June 2003**
8 June 1998	115,000	0.3875	8 June 2001	7 June 2005
17 August 1998	125,000	0.5275	17 August 2001	16 August 2008
17 August 1998	54,322	0.5275	17 August 1999	16 August 2003**
16 October 1998	51,000	0.405	16 October 2001	15 October 2008
16 October 1998	34,550	0.405	16 October 1999	15 October 2003**
11 March 1999	2,909,507	1.224	11 March 2002	10 March 2009
11 March 1999	1,489,869	1.224	11 March 2000	10 March 2004**
11 March 1999	4,986,040	1.224	11 March 2002	10 March 2006
4 May 1999	158,259	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*	11,240	1.099	1 July 2004	31 December 2004
10 August 1999	75,490	1.765	10 August 2002	9 August 2009
10 August 1999	40,002	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	121,250	7.738	1 February 2003	31 January 2010
1 February 2000	52,500	7.738	1 February 2001	31 January 2005**
1 February 2000	70,000	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*	26,481	5.65	1 July 2003	31 December 2003
19 May 2000*	4,896	5.65	1 July 2005	31 December 2005
22 May 2000	346,763	6.155	22 May 2003	21 May 2010
22 May 2000	794,000	6.155	22 May 2001	21 May 2005**
22 May 2000	2,689,555	6.155	22 May 2001	21 May 2007**
7 August 2000	24,250	6.70	7 August 2001	6 August 2005**
7 August 2000	162,500	6.70	7 August 2001	6 August 2007**
13 October 2000	145,750	6.33	13 October 2001	12 October 2005**
13 October 2000	252,500	6.33	13 October 2001	12 October 2007**
15 February 2001	83,000	4.43	15 February 2002	14 February 2006**
15 February 2001	436,500	4.43	15 February 2002	14 February 2008**
14 May 2001	590,521	3.35	14 May 2004	13 May 2011
14 May 2001	1,305,900	3.35	14 May 2002	13 May 2006**
14 May 2001	3,760,529	3.35	14 May 2002	13 May 2008**

17 Called-up share capital continued

Date of issue	Ordinary shares of 0.05 pence each Number	Exercise price per share £	Period of option Earliest date	Latest date
19 May 2001*	203,480	3.069	1 July 2004	31 December 2004
19 May 2001*	28,366	3.069	1 July 2006	31 December 2006
19 May 2001*	22,349	3.069	1 July 2003	30 September 2003
22 May 2001	62,909	3.815	22 May 2004	21 May 2008†
1 August 2001	58,813	2.84	1 August 2004	31 July 2011
1 August 2001	28,000	2.84	1 August 2002	31 July 2006**
1 August 2001	20,822	2.84	1 August 2002	31 July 2008**
6 November 2001	139,000	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**
5 March 2002	62,500	3.145	5 March 2003	4 March 2007**
5 March 2002	176,250	3.145	5 March 2003	4 March 2009**
19 April 2002	1,072,098	2.465	19 April 2005	18 April 2012
19 April 2002	4,294,629	2.465	19 April 2003	18 April 2009**
19 April 2002	406,896	2.465	19 April 2005	18 April 2009†
19 April 2002	1,500,675	2.465	19 April 2003	18 April 2007**
20 June 2002*	905,064	1.82537	1 July 2005	31 December 2005
20 June 2002*	242,922	1.82537	1 July 2007	31 December 2007
20 June 2002*	189,140	1.82537	1 July 2004	30 September 2004
27 May 2002	223,515	2.1475	27 May 2003	26 May 2009**
15 August 2002	128,500	1.505	15 August 2003	14 August 2007**
15 August 2002	378,250	1.505	15 August 2003	14 August 2009**
16 October 2002	68,750	0.425	16 October 2003	15 October 2007**
16 October 2002	120,000	0.425	16 October 2003	15 October 2009**
8 November 2002	3,500	0.5725	8 November 2003	7 November 2007**
8 November 2002	35,000	0.5725	8 November 2003	7 November 2009**
Total	35,051,349			

* 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 Share premium account and reserves

Group	Share premium account £000	Other reserves £000	Profit and loss account £000
At 1 January 2002	76,124	144	60,752
Prior year adjustment	–	–	584
At 1 January 2002 as restated	76,124	144	61,336
Foreign exchange difference on consolidation	–	(807)	–
Premium on exercise of share options	4,759	–	–
Retained profit for the year	–	–	32,239
At 31 December 2002	**80,883**	**(663)**	**93,575**

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

Prior year adjustment The group has adopted FRS 19, "Deferred taxation", during the year by means of a prior year adjustment. The current year effect of this is to decrease the tax charge by £500,000. The effect for 2001 is to increase the tax charge by £268,000 and to increase shareholders' funds and the deferred tax debtor at 31 December 2001 by £584,000.

Company	Share premium account £000	Profit and loss account £000
At 1 January 2002	76,124	3,552
Premium on exercise of share options	4,759	–
Retained profit for the year	–	772
At 31 December 2002	**80,883**	**4,324**

The adoption of FRS 19, "Deferred taxation", has had no impact on the results of the Company.

19 Reconciliation of movements in shareholders' funds

Group	**2002 £000**	2001 £000*
Profit attributable to shareholders	**32,239**	34,389
Other recognised gains and losses relating to the year	**(807)**	14
New share capital issued	**4**	7
Share premium on issue of new shares	**4,759**	1,551
Net addition to shareholders' funds	**36,195**	35,961
Opening shareholders' funds as previously reported	**137,527**	101,298
Prior year adjustment (see note 18)	**584**	852
Opening shareholders' funds as restated	**138,111**	102,150
Closing shareholders' funds	**174,306**	138,111

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

20 Minority interests

	2002 £000	2001 £000
At 1 January	**609**	306
Profit and loss account	**232**	303
Equity minority interests at 31 December	**841**	609

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

	2002 £000	2001 £000
Operating profit	**41,129**	45,782
Depreciation on tangible fixed assets	**12,463**	9,327
(Profit)/loss on sale of tangible fixed assets	**(14)**	187
Amortisation of goodwill	**1,352**	1,979
Amortisation of other intangible assets	**2,777**	1,091
Amounts written off unlisted investments	**826**	272
(Increase) in stocks	**(934)**	(196)
Decrease/(increase) in trade debtors	**4,293**	(5,896)
Trade debtors converted to unlisted investments	**–**	(1,361)
(Increase) in prepayments and accrued income	**(4,960)**	(2,037)
Increase in trade creditors	**2,369**	312
Increase in other taxation and social security	**40**	194
(Decrease)/increase in accruals, deferred income and other creditors	**(7,060)**	7,338
Movement in provisions for liabilities and charges	**(194)**	9
Net cash inflow from operating activities	**52,087**	57,001

22 Reconciliation of net cash flow to movement in net funds

	2002 £000	2001 £000
(Decrease)/increase in cash for the year	**(5,072)**	4,324
Cash outflow from purchase of short-term investments	**31,637**	24,893
Change in net funds from cash flows	**26,565**	29,217
Non-cash items:		
Translation difference	**(728)**	(16)
Movement in net funds in the year	**25,837**	29,201
Net funds at start of the year	**104,467**	75,266
Net funds at end of the year	**130,304**	104,467

23 Analysis of net funds

	Cash at bank and in hand £000	Short-term investments £000	Total £000
At 1 January 2002	10,091	94,376	104,467
Cash flow	(5,072)	31,637	26,565
Translation differences	(728)	–	(728)
At 31 December 2002	**4,291**	**126,013**	**130,304**

24 Cash flow from acquisitions

	2002 £000	2001 £000
Acquisitions		
Purchase of assets and trade	**–**	(1,200)
Acquisition expenses	**–**	(151)
Net cash outflow from acquisitions	**–**	(1,351)

25 Capital commitments

Group	2002 £000	2001 £000
Capital expenditure that has been contracted for but has not been provided for in the financial statements	**1,714**	488

The Company had no capital commitments at 31 December 2002 and 2001.

26 Financial commitments and contingencies

At 31 December 2002, the group had annual commitments under non-cancellable operating leases as follows:

	2002		2001	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
Expiring within one year	**321**	**8**	369	–
Expiring between two and five years inclusive	**894**	**1,778**	957	57
Expiring in over five years	**2,110**	**–**	2,110	–
	3,325	**1,786**	3,436	57

At 31 December 2002 and 2001 the Company had no annual commitments under non-cancellable operating leases.

The group has an obligation, if certain criteria are met, to make a $3,000,000 investment representing a minority holding in a fabless semiconductor company that is set up to create and sell ARM core-based microprocessor cores to be licensed from ARM.

In 2002 a lawsuit was filed against the group claiming that the group's Jazelle technology for Java™ acceleration infringes a US patent. The group is confident that its products do not infringe the patent cited in the lawsuit or any other patents, is defending the action vigorously and believes that the matter could be concluded quickly.

27 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.

There were no related party transactions during 2002 or 2001 which require disclosure.

28 Summary of significant differences between United Kingdom Generally Accepted Accounting Principles (US 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.

Goodwill Under UK GAAP, goodwill is amortised on a straight-line basis over an estimate of the time that the group is expected to benefit from it. This was also the group's accounting policy under US GAAP prior to 1 January 2002, on which date, following the provisions of SFAS 142, "Goodwill and other intangible assets", the carrying value of goodwill was frozen and became subject to annual impairment reviews. The transitional impairment review carried out on adoption of SFAS 142 did not give any indication of impairment.

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.

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, net of deferred taxation, are recorded in other comprehensive income. Under UK GAAP, the group's accounting policy is to carry such investments at cost less any provisions for diminution in value.

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. Investment in own shares is held at the lower of cost and amounts receivable on exercise of options, where applicable, and market value. Under US GAAP, these shares are treated as treasury stock and are included within shareholders' equity, at original cost.

Save As You Earn (SAYE) plans Under UK GAAP, the group has taken advantage of the exemption provided by UITF 17, "Employee share schemes", not to recognise any compensation charge in respect of options granted under SAYE plans. Under US GAAP, the group follows the requirements of EITF 00-23, which does not permit such an exemption in respect of plans where the savings period is in excess of 27 months, as is the case with the group's Inland Revenue approved UK SAYE plans. EITF 00-23 applies only to new offers made since 24 January 2002. The compensation charge made under US GAAP is calculated as the difference between the market price of the shares at the date of grant and the exercise price of the option and is recorded on a straight-line basis over the savings period.

Employee share options 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 accounted for when the options are exercised.

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 certain 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.

Embedded derivatives Under US GAAP, where the group enters into sales contracts denominated in a currency that is neither the functional currency of the group nor the functional currency of the customer and where there are uninvoiced amounts on such contracts, such derivatives are carried at fair value. The resulting gain or loss is recognised in the income statement. Embedded derivatives are not revalued to fair value under UK GAAP.

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.

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.

28 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

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

	2002 £000	2001 £000
Group operating profit as reported under UK GAAP	**41,129**	45,782
Adjustments for:		
Movement in provision for employer's taxes on share options	**(194)**	(9)
Compensation charge in respect of SAYE options	**(56)**	–
Net gains on disposals of trade investments	**–**	314
Difference on amortisation of goodwill	**1,352**	50
Mark-to-market of embedded derivatives	**(950)**	–
Income from operations as reported under US GAAP	**41,281**	46,137

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

	2002 £000	2001 £000
Profit before tax as reported under UK GAAP	**45,502**	50,566
Adjustments for:		
Movement in provision for employer's taxes on share options	**(194)**	(9)
Compensation charge in respect of SAYE options	**(56)**	–
Difference on amortisation of goodwill	**1,352**	50
Mark-to-market of embedded derivatives	**(950)**	–
Minority interest	**(232)**	(303)
Income before income tax as reported under US GAAP	**45,422**	50,304

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

	2002 £000	2001 £000*
Retained profit as reported under UK GAAP	**32,239**	34,389
Adjustments for:		
Movement in provision for employer's taxes on share options	**(194)**	(9)
Compensation charge in respect of SAYE options	**(56)**	–
Difference on amortisation of goodwill	**1,352**	50
Mark-to-market of embedded derivatives	**(950)**	–
Tax deduction for US employee share options	**(754)**	(428)
Net income as reported under US GAAP	**31,637**	34,002

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

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

	2002 £000	2001 £000*
Shareholders' funds as reported under UK GAAP	**174,306**	138,111
Adjustments for:		
Investment in own shares/treasury stock	**(18,034)**	(19,934)
Contribution to QUEST, net of proceeds from allocation of shares	**15,868**	17,546
Provision for employer's taxes on share options	**16**	210
Write-off of in-process research and development	**(150)**	(150)
Cumulative difference on amortisation of goodwill	**1,414**	62
Fair value of embedded derivatives	**(950)**	–
Shareholders' equity as reported under US GAAP	**172,470**	135,845

* The prior year's figures have been restated solely as a result of the adoption of FRS 19, "Deferred taxation" (see note 18).

28 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

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

	2002 £000	2001 £000
Cash as reported under UK GAAP	**4,291**	10,091
Adjustment for short-term investments treated as cash equivalents under US GAAP	**126,013**	94,376
Cash and cash equivalents as reported under US GAAP	**130,304**	104,467

Selected consolidated financial data/US GAAP

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 61 to 78 of this report.

Selected consolidated financial data – US GAAP

	1998 £000	1999 £000	2000 £000	2001 £000	**2002** **£000**
Revenues	42,268	62,120	100,730	146,274	**150,922**
Cost of revenues	8,316	9,803	11,647	17,289	**13,185**
Operating expenses	26,361	36,530	57,846	82,848	**96,456**
Income from operations	7,591	15,787	31,237	46,137	**41,281**
Interest, net	1,911	2,266	3,912	4,470	**4,373**
Share of loss of equity affiliate	(71)	–	(85)	–	**–**
Gain on partial disposal of shares in equity affiliate	–	–	512	–	**–**
Minority interest	(8)	(64)	(192)	(303)	**(232)**
Income before income tax	9,423	17,989	35,384	50,304	**45,422**
Provision for income taxes	3,371	1,757	6,007	16,302	**13,785**
Net income	6,052	16,232	29,377	34,002	**31,637**
Diluted earnings per common share	0.4p	1.6p	2.9p	3.3p	**3.1p**
IPO dividend per common share	0.5p	–	–	–	**–**
Research and development as a percentage of revenues	30.1%	27.6%	26.2%	25.3%	**31.3%**
Capital expenditure	£6,402	£5,900	£11,842	£17,349	**£15,616**
Cash and cash equivalents	£39,591	£51,804	£75,266	£104,467	**£130,304**
Shareholders' equity	£48,280	£67,113	£100,972	£135,845	**£172,470**
Total assets	£60,580	£83,288	£127,343	£175,814	**£205,744**
Employees at year end (number)	354	443	619	722	**721**

Operating and financial review and prospects/US GAAP

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 reduced instruction set computing (RISC) microprocessors and related technology and software, and licenses this IP to semiconductor 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 the ARM architecture and supporting development tools and software.

Market conditions The challenging economic environment and severe downturn in the semiconductor industry persisted throughout 2002. In this context, ARM reported robust results in the first half of the year. However, when the industry upturn foreseen by many commentators in the second half of 2002 did not materialize, we experienced some deferment of licensing decisions by our Partners and a consequent slowdown in licensing activity. The slowdown continues to persist.

This slowdown in licensing activity caused us to realign our expectations for short- to medium-term revenue growth and we took the decision to adjust our cost base to be commensurate with our revised expectations. Despite the unhelpful market background, we continue to invest in the future ARM technology roadmap by maintaining a high level of research and development expenditure and are, therefore, particularly pleased that even with a slowdown in licensing activity in the second half we remain strongly profitable and cash generative. Indeed, in the second half alone the total net cash inflow from operating activities was £30.8 million, giving rise to a year end cash balance of over £130 million.

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		
	2000 %	2001 %	**2002 %**
Revenues:			
Product revenues	83.9	87.5	**88.1**
Service revenues	16.1	12.5	**11.9**
Total revenues	100.0	100.0	**100.0**
Cost of revenues:			
Product costs	4.6	5.6	**4.3**
Service costs	7.0	6.2	**4.4**
Total cost of revenues	11.6	11.8	**8.7**
Gross profit	88.4	88.2	**91.3**
Operating expenses:			
Research and development	26.2	25.3	**31.3**
Sales and marketing	17.7	14.7	**16.4**
General and administrative	12.2	15.4	**14.9**
Amortization of goodwill	1.3	1.3	**–**
Restructuring costs	–	–	**1.3**
Total operating expenses	57.4	56.7	**63.9**
Income from operations	31.0	31.5	**27.4**
Interest, net	3.9	3.1	**2.9**
Share of loss of equity affiliate	(0.1)	–	**–**
Gain on partial disposal of equity affiliate	0.5	–	**–**
Minority interest	(0.2)	(0.2)	**(0.2)**
Income before income tax	35.1	34.4	**30.1**
Provision for income taxes	6.0	11.1	**9.1**
Net income	29.1	23.3	**21.0**

Total revenues Total revenues were £150.9 million in 2002, an increase of 3% from £146.3 million in 2001, which was a 45% increase from £100.7 million in 2000.

Product revenues Product revenues consist of license fees, sales of development systems and royalties. Product revenues for 2000, 2001 and 2002 were £84.6 million, £128.0 million and £133.0 million, representing 84%, 87% and 88% of total revenues respectively.

License revenues increased from £45.4 million in 2000 to £76.8 million in 2001 and to £83.0 million in 2002 representing approximately 45%, 52% and 55% of total revenues in 2000, 2001 and 2002 respectively. The importance of the ARM7 family declined further in 2002, accounting for 36% of revenues in 2000, 20% in 2001 and 15% in 2002. 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, the first core in the ARM11 family of products and 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 31% of revenues in 2000, 44% in 2001 and 43% in 2002. 33 new licensees were signed in 2002 bringing the total number of semiconductor Partners to 108. Of the 33 new licensees, 23 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 2002 with 37 separate products licensed by 25 different Partners during the year. Of these, 21 were for products from microprocessor core families not previously licensed, and 16 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 89% of total license fees in 2002; this compares to approximately 80% in 2001 and 66% in 2000.

The sale of non-core licenses, covering items such as platforms, peripherals, embedded trace modules, models, and sub-systems, increased in 2002 to £12.6 million from £11.9 million in 2001 and £7.8 million in 2000 representing approximately 15% of license revenues in 2002, 15% in 2001 and 17% in 2000.

Revenues from the sale of Development Systems increased from £13.6 million in 2000 to £23.3 million in 2001, falling slightly to £23.1 million in 2002 representing approximately 14%, 16% and 15% of total revenues in 2000, 2001 and 2002 respectively. The majority of ARM's sales of Development Systems are in US dollars and the US dollar value of sales of development systems in 2002 was approximately 3% higher than in 2001. The effect of the strong pound against the US dollar was to reduce the sterling value of sales. Sales of Development Systems were also affected by increased competition in the debug tools marketplace, which saw the volume of sales of ARM's debug solutions increasing, but the value of sales decreasing as prices were cut to remain competitive.

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 the beginning of October of the previous year to the end of September of the current year. Royalties increased from £25.6 million in 2000, to £27.9 million in 2001, and decreased to £26.8 million in 2002, representing 25%, 19% and 18% of total revenues in 2000, 2001 and 2002 respectively. Volume shipments increased from 367 million units in 2000, to 420 million units in 2001, mainly due to an increase in the sale of products such as printers, digital cameras, smart cards, disk drives and networking products. Unit shipments in 2002 were 456 million, with the increase in volumes coming from increased production of a wide range of electronic devices, including wireless handsets, secure products and automotive products. The Company expects royalty revenues to grow year on year although they may be subject to significant fluctuations from quarter to quarter. The proportion of unit shipments into the non-wireless markets has increased in 2002 and the Company expects this trend to continue into 2003.

Service revenues Service revenues consist of design consulting services and revenues from support, maintenance and training. Service revenues increased from £16.2 million in 2000, to £18.3 million in 2001, and decreased to £18.0 million in 2002, representing 16%, 13% and 12% of total revenues in 2000, 2001 and 2002 respectively. Consulting revenues decreased from £8.2 million in 2000, to £7.4 million in 2001, and £4.4 million in 2002, as engineering resource was directed away from consulting projects to research and development activities. Revenues from support, maintenance and training increased from £8.0 million in 2000 to £10.9 million in 2001 and £13.5 million in 2002.

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 2002 was 44% of revenues coming from the US, 25% from Japan, 13% from Asia Pacific, excluding Japan, and 18% from Europe. In 2001, revenues from the US represented 49%, Japan 23%, Asia Pacific, excluding Japan, 9%, and Europe 19%. In 2000, 55% of revenues came from the US, 18% from Japan, 7% from Asia Pacific, excluding Japan, and 20% 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 2000, £8.2 million in 2001 and £6.5 million in 2002 representing 5%, 6% and 4% of total revenues in 2000, 2001 and 2002 respectively. Approximately two-thirds of total product cost of sales were made up of development systems costs in 2002, with the balance comprising additional costs related to the costs of third-party operating systems. This compares to approximately four-fifths of total product cost of sales being made up of development systems costs in 2000 and 2001, with the balance being costs associated with third-party operating systems. Product gross margin in 2002 increased slightly to 95%, compared to 94% in 2001 and 95% in 2000. The Company does not currently expect a significant increase in product costs in 2003, 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 ARM technology as well as the costs directly attributable to consulting work performed for third parties. Cost of services increased from approximately £7.1 million in 2000 to £9.1 million in 2001, and fell to £6.7 million in 2002. The gross margins earned on service revenues were approximately 56% in 2000, 50% in 2001, and 63% in 2002. The gross margin increased in 2002 due to a shift in engineering resource from low-margin consulting projects to more profitable IP-generating activities.

Research and development costs Research and development costs increased from £26.4 million in 2000 to £36.9 million in 2001, and £47.3 million in 2002, representing 26%, 25% and 31% of total revenues in 2000, 2001 and 2002, respectively. 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 the development of additional versions of the ARM11 core and platform, first implementations of ARM's intelligent energy management technology, additions to the PrimeXsys range of system IP platforms, research into future microprocessor architectures, multi-processing solutions and enhanced application software and development systems products.

Total engineering headcount increased from 376 at the end of 2000 to 429 at the end of 2001, and was 420 at the end of 2002. In addition, there were approximately 15 contractors in 2000, 18 in 2001 and 18 in 2002.

Sales and marketing Sales and marketing expenditure increased from £17.8 million in 2000, to £21.5 million in 2001, and £24.7 million in 2002, representing 18% of total revenues in 2000, 15% in 2001, and 16% in 2002. Headcount in this area increased from 162 at December 31, 2000, to 198 at December 31, 2001, and 208 at December 31, 2002. The total number of offices with sales people is currently 14 and this enables improved contact with the Company's geographically diverse customer base. In 2001, a further sales office was opened in the US and in 2002 a sales office was opened in Shanghai, PR China.

General and administrative General and administrative headcount increased from 81 at December 31, 2000, to 95 at December 31, 2001, and was 93 at December 31, 2002. General and administrative costs rose from £12.3 million in 2000 to £22.5 million in 2001 and were £22.5 million in 2002, representing 12%, 15% and 15% of total revenues, respectively. In 2001, legal costs increased to £5.5 million, largely attributable to the Company's now-resolved litigation against picoTurbo Inc., human resources costs grew by £2 million, with greater emphasis on employee training, and establishment costs rose by £1 million with improved office accommodation. In 2002, Nazomi Communications, Inc. filed a lawsuit against ARM before the Federal District Court for Northern California claiming that ARM's Jazelle technology for Java acceleration infringes a US patent owned by Nazomi. ARM is confident that its products do not infringe the patent cited in the lawsuit or any other Nazomi patents. Total legal costs were £4.1 million in 2002. Expense in relation to provisions for doubtful debts was £1.4 million in 2002, compared to £0.7 million in 2001 and a release of provision of £0.2 million in 2000, reflecting more difficult trading conditions for many of our smaller customers. Unrealized future foreign exchange losses on certain committed but not yet invoiced future revenue streams of £0.9 million (2001: £nil; 2000: £nil) were recorded in accordance with SFAS 133. There was a gain on foreign exchange of £0.1 million in 2000, an exchange loss of £0.2 million in 2001 and an exchange gain of £0.5 million in 2002. See "Foreign Currency Fluctuations" below.

Restructuring costs During 2002, the Company incurred restructuring costs of £2.0 million comprising mainly severance payments, all of which were paid during the fourth quarter following a reduction in total headcount of 98 people representing 12% of the Company's workforce. It is anticipated that this reduction in the workforce will reduce employee costs by approximately £5 million per annum.

Amortization of goodwill and intangible assets 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. Amortization of goodwill of £1.9 million was charged to the income statement in 2001 and £1.3 million was charged in 2000. In-process research and development costs of £0.2 million relating to the acquisition of Allant Software Corporation were written off in 2000. There was no charge for goodwill in 2002 following the Company's adoption of SFAS 142, "Goodwill and other intangible assets".

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 (2001: £0.9 million, 2000: £0.2 million) amortized during 2002. The Company also purchased a new license for £1.1 million in 2001 to enable the Company to produce and license Java technology-related products. This is being amortized over a period of five years with £0.2 million amortized during 2001 and £0.2 million amortized during 2002. A further license was purchased in 2002 for £0.2 million. This is being amortized over three years.

Following the conclusion of the Company's litigation against picoTurbo, Inc. in December 2001, picoTurbo assigned its intellectual property rights to the Company for a payment of £7.5 million. This is being amortized over five years and £1.5 million was charged to the income statement in 2002.

The Company also purchased a patent for £0.7 million in 2002 which is being amortized over five years. The amortization charge for 2002 was £0.1 million.

The adoption of SFAS 142, "Goodwill and other intangible assets", has not resulted in any impairment of the Company's goodwill or intangible assets.

Interest Interest grew from £3.9 million in 2000 to £4.5 million in 2001 and was £4.3 million in 2002. The growth in interest earned between 2000 and 2001 was lower than the growth in cash balances, and interest earned fell slightly between 2001 and 2002 reflecting the drop in market interest rates during 2001 and 2002. The Company invested cash balances over periods of up to three months during 2002.

Income before income tax Income before income tax grew from £35.4 million in 2000 to £50.3 million in 2001 and was £45.4 million in 2002, representing 35%, 34% and 30% of total revenues respectively. The slight drop in margins between 2000 and 2001 was partly due to lower returns on cash deposits. The drop in margins in 2002 was a result of lower than anticipated revenues in the second half of the year.

Tax charge The Company's effective tax rates were 17% in 2000, 32% in 2001 and 30% in 2002. The principal reason for the lower tax rate in 2000 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 Company. The contribution by the Company to the QUEST for the purchase of shares by the QUEST is a tax-deductible expense under existing UK tax legislation. The Company made two contributions to the QUEST in March 2000 and November 2000, when the QUEST purchased 1,483,440 shares and 559,559 shares respectively. The Company did not make further contributions to the QUEST in 2001 or 2002 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 £42.7 million, £52.0 million and £39.5 million in 2000, 2001 and 2002 respectively. 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 and in 2002 accounts receivable decreased by £2.9 million and deferred revenues fell by £5.0 million. In 2002 prepaid expenses increased by £5.3 million, compared to an increase of £1.4 million and £1.0 million in 2001 and 2000, respectively. The Company entered into several leases for design automation tools during 2002, which resulted in the large increase in prepaid expenses. The Company believes that, given its current level of business, it has sufficient working capital for the foreseeable future.

At December 31, 2002, the Company recorded approximately £14.4 million in deferred revenues which represented cash or receivables scheduled to be recognized as revenues in varying amounts after December 31, 2002. At December 31, 2001, and December 31, 2000, the Company recorded approximately £19.4 million and £12.7 million respectively in deferred revenues.

Cash flow from operations has been used to fund the working capital requirements of the Company as well as capital expenditure. Capital expenditure in 2002 was £15.6 million, compared to £17.3 million in 2001 and £11.8 million in 2000. The increasing expenditures between 2000 and 2001 were 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 centers in the UK, France and the US. In 2002, capital expenditure decreased as a result of the Company leasing some of the design automation tools that would have previously been purchased. 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. In 2002, £15.6 million was spent on computer equipment, software, leasehold improvements and fixtures and fittings.

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 in 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 1996, the Company made two investments in small start-up companies, namely Sirius Communications NV and Palmchip Corporation ("Palmchip"). These investments 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.

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, in 2001 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. In 2002, the Company made one investment in an available-for-sale security, namely Superscape plc, for a consideration of £1.5 million.

Cash balances at December 31, 2002, were £130.3 million compared to £104.5 million at December 31, 2001. At December 31, 2001, accounts receivable net of allowances for doubtful debts were £24.8 million and £20.5 million at December 31, 2002, which represented 17% and 14% 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 US 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 $3.5 million in 2000, $3.0 million in 2001, and $7.2 million in 2002. 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 December 31, 2000, 2001 and 2002 are disclosed in footnote 12 to the financial statements. The settlement period of the forward contracts outstanding at December 31, 2002 is between January 17 and March 24, 2003.

Risk factors The Company operates in the intensely competitive semiconductor industry which is 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, 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 2002.

Consolidated statements of income and comprehensive income/US GAAP

	2000 £000	2001 £000	**2002 £000**	**2002* $000**
Revenues:				
Product revenues	84,562	127,976	**132,911**	**213,987**
Service revenues	16,168	18,298	**18,011**	**28,998**
Total revenues	100,730	146,274	**150,922**	**242,985**
Cost of revenues:				
Product costs	4,566	8,209	**6,464**	**10,407**
Service costs	7,081	9,080	**6,721**	**10,821**
Total cost of revenues	11,647	17,289	**13,185**	**21,228**
Gross profit	89,083	128,985	**137,737**	**221,757**
Operating expenses:				
Research and development	26,359	36,941	**47,299**	**76,151**
Sales and marketing	17,841	21,457	**24,711**	**39,785**
General and administrative	12,349	22,521	**22,486**	**36,202**
Restructuring costs	–	–	**1,960**	**3,156**
Amortization of goodwill	1,297	1,929	**–**	**–**
Total operating expenses	57,846	82,848	**96,456**	**155,294**
Income from operations	31,237	46,137	**41,281**	**66,463**
Interest, net	3,912	4,470	**4,373**	**7,040**
Share of loss of equity affiliate	(85)	–	**–**	**–**
Gain on partial disposal of equity affiliate	512	–	**–**	**–**
Minority interest	(192)	(303)	**(232)**	**(374)**
Income before income tax	35,384	50,304	**45,422**	**73,129**
Provision for income taxes	6,007	16,302	**13,785**	**22,194**
Net income	29,377	34,002	**31,637**	**50,935**
Net income	29,377	34,002	**31,637**	**50,935**
Other comprehensive income:				
Foreign currency adjustments, net of tax	75	14	**(807)**	**(1,299)**
Unrealised holding gain/(loss) on available-for-sale securities, net of tax	2,087	(2,087)	**–**	**–**
Total comprehensive income	31,539	31,929	**30,830**	**49,636**
Basic earnings per common share	3.0p	3.4p	**3.1p**	
Diluted earnings per common share	2.9p	3.3p	**3.1p**	

* US dollar amounts have been translated from sterling at the December 31, 2002, closing rate of £1.00 = $1.610 and are unaudited (see note 1).

All activities relate to continuing operations.

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

Consolidated balance sheets/US GAAP

	2001 £000	**2002 £000**	**2002* $000**
Assets			
Current assets:			
Cash and cash equivalents	104,467	**130,304**	**209,789**
Accounts receivable, net of allowances for doubtful debts of £2,193,000 (2001: £800,000)	24,809	**20,516**	**33,031**
Inventory: finished goods	581	**1,515**	**2,439**
Prepaid expenses and other assets	6,006	**11,345**	**18,266**
Income taxes receivable	550	**–**	**–**
Total current assets	136,413	**163,680**	**263,525**
Deferred income taxes	839	**1,697**	**2,732**
Property and equipment, net	22,668	**25,721**	**41,411**
Intangible assets	12,339	**10,417**	**16,771**
Investments	3,555	**4,229**	**6,809**
Total assets	175,814	**205,744**	**331,248**
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	2,361	**4,730**	**7,615**
Income taxes payable	7,054	**3,828**	**6,163**
Personnel taxes	784	**824**	**1,327**
Accrued liabilities	9,741	**8,636**	**13,904**
Deferred revenue	19,420	**14,415**	**23,208**
Commitments and contingencies (note 10)	–	**–**	**–**
Total liabilities	39,360	**32,433**	**52,217**
Minority interest	609	**841**	**1,354**
	39,969	**33,274**	**53,571**
Shareholders' equity			
Ordinary shares: £0.0005 par value; 1,580,000,000 authorized (2001: 1,580,000,000); 1,021,758,000 issued (2001: 1,014,767,176)	507	**511**	**823**
Additional paid-in capital	65,362	**69,566**	**112,001**
Deferred compensation	–	**(313)**	**(504)**
Treasury stock, at cost: 6,796,754 ordinary shares (2001: 7,017,599)	(19,934)	**(18,034)**	**(29,035)**
Retained earnings	89,766	**121,403**	**195,459**
Other comprehensive income:			
Cumulative translation adjustment	144	**(663)**	**(1,067)**
Total shareholders' equity	135,845	**172,470**	**277,677**
Total liabilities and shareholders' equity	175,814	**205,744**	**331,248**

* US dollar amounts have been translated from sterling at the December 31, 2002, closing rate of £1.00 = $1.610 and are unaudited (see note 1).

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

Consolidated statements of cash flows/US GAAP

	2000 £000	2001 £000	**2002 £000**	**2002* $000**
Cash flows from operating activities				
Net income	29,377	34,002	**31,637**	**50,936**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of tangible and intangible assets	7,777	12,347	**15,240**	**24,536**
Write-off of in-process research and development	150	–	**–**	**–**
Stock option compensation	–	–	**56**	**90**
Share of loss of equity affiliates	85	–	**–**	**–**
Deferred income taxes	560	359	**(858)**	**(1,381)**
Tax effect of disqualifying dispositions	–	428	**754**	**1,214**
Gain on partial disposal of equity affiliate	(512)	–	**–**	**–**
Provision for doubtful accounts	(248)	673	**1,393**	**2,243**
Accounts receivable converted to trade investments	–	(1,361)	**–**	**–**
Amount written off investments	–	613	**826**	**1,330**
Other	262	(164)	**218**	**351**
Changes in operating assets and liabilities:				
Accounts receivable	(4,747)	(6,569)	**2,900**	**4,669**
Inventory	(184)	(196)	**(934)**	**(1,504)**
Prepaid expenses and other current assets	(996)	(1,354)	**(5,339)**	**(8,596)**
Accounts payable	957	312	**2,369**	**3,814**
Income taxes payable	2,519	5,322	**(2,676)**	**(4,308)**
Deferred revenue	5,149	6,743	**(5,005)**	**(8,058)**
Accrued liabilities and other creditors	2,513	613	**(1,105)**	**(1,779)**
Personnel taxes	77	194	**40**	**64**
Net cash provided by operating activities	42,739	51,962	**39,516**	**63,621**
Cash flows from investing activities:				
Receipt from partial disposal of equity affiliate	517	–	**–**	**–**
Purchase of equipment	(7,182)	(13,377)	**(8,670)**	**(13,959)**
Purchase of leasehold improvements	(4,660)	(3,972)	**(6,946)**	**(11,183)**
Sale of equipment	59	71	**35**	**56**
Purchase of patent and licenses	(2,822)	(8,568)	**(855)**	**(1,376)**
Purchase of investments	(4,088)	–	**(1,500)**	**(2,415)**
Sale of investments	–	1,936	**–**	**–**
Purchase of subsidiaries and businesses, net of cash acquired	(3,414)	(1,351)	**–**	**–**
Net cash used in investing activities	(21,590)	(25,261)	**(17,936)**	**(28,877)**
Cash flows from financing activities:				
Cash received on issue of shares on exercise of share options	2,320	1,558	**4,763**	**7,668**
Proceeds received on issuance of shares	–	958	**222**	**357**
Net cash provided by financing activities	2,320	2,516	**4,985**	**8,025**
Effect of foreign exchange on cash and cash equivalents	(7)	(16)	**(728)**	**(1,172)**
Net increase in cash and cash equivalents	23,462	29,201	**25,837**	**41,597**
Cash and cash equivalents at beginning of the period	51,804	75,266	**104,467**	**168,192**
Cash and cash equivalents at end of the period	75,266	104,467	**130,304**	**209,789**
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	2,928	9,643	**16,758**	
Cash received on interest	3,775	4,604	**4,187**	

* US dollar amounts have been translated from sterling at the December 31, 2002, closing rate of £1.00 = $1.610 and are unaudited (see note 1).

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

Consolidated statements of changes in shareholders' equity/US GAAP

	Ordinary shares Number**	Ordinary shares Amount £000	Additional paid-in capital £000	Cumulative translation adjustment £000	Treasury stock £000	Unrealized holding gain £000	Deferred compensation £000	Retained earnings* £000	Total £000
Balances, January 1, 2000	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
Shares issued 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
Shares issued 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 disqualifying dispositions			428						428
Currency translation adjustment				14					14
Issuance of shares			(14,652)		15,610				958
Balances, December 31, 2001	1,014,767,176	507	65,362	144	(19,934)	–	–	89,766	135,845
Shares issued on exercise of options	6,990,824	4	4,759						4,763
Net income								31,637	31,637
Tax effect of disqualifying dispositions			754						754
Deferred compensation arising on SAYE plan			369				(369)		–
Amortization of deferred compensation							56		56
Currency translation adjustment				(807)					(807)
Issuance of shares			(1,678)		1,900				222
Balances, December 31, 2002	**1,021,758,000**	**511**	**69,566**	**(663)**	**(18,034)**	**–**	**(313)**	**121,403**	**172,470**

* 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, 2002 such distributable profits amounted to £4,324,000.

** The number of shares and the dividend per share have been adjusted, where applicable, to reflect 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 ("ARM" or "the Company") design reduced instruction set computing (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 Company licenses and sells its technology and products to leading international electronics companies, which in turn manufacture, market and sell microprocessors, application-specific integrated circuits (ASICs) and application-specific standard processors (ASSPs) based on the Company'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 Company's technology, the Company 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 Company also licenses and sells development systems direct to systems companies and provides consulting and support services to its licensees, systems companies and other systems designers. The Company's principal geographic markets are Europe, the US and Asia Pacific.

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 UK), ARM, INC. (incorporated in the US), 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), ARM Taiwan Limited (incorporated in Taiwan) and ARM Consulting (Shanghai) Co. Limited (incorporated in PR China).

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 United States (US GAAP).

The Company maintains its accounting records and prepares its financial statements in British sterling. Purely for the convenience of the reader, the December 31, 2002, consolidated financial statements have been translated from sterling at the closing rate on December 31, 2002, of £1.00 = $1.610. Such translations should not be construed as representations that the sterling amounts represent, or have been or could be so converted into US dollars at that rate or at any other rate.

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.

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 Company owns between 20% and 50% of the voting stock are treated as equity affiliates. During 2000, the Company 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, 2001, or at December 31, 2002.

Investments Publicly traded 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 31, 2002 and 2001, the estimated fair value of these investments approximated their recorded basis, based on estimates determined by management.

The Company 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. Equity shares in both companies were received in settlement of accounts receivable.

The Company sold its 3% stake in Sirius Communications NV during 2001.

The Company 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.

During 2002, the Company made an 11.99% investment in Superscape plc, a company listed on the London Stock Exchange.

Intangible assets Purchased 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.

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

Goodwill Goodwill represents the excess of the fair value of the consideration paid on acquisition of a business over the fair value of the assets, including any intangible assets identified and liabilities acquired.

Prior to 2002, purchased goodwill was capitalized and amortized on a straight-line basis over a prudent estimate of the time that the Company is expected to benefit from it. Upon adoption of SFAS 142, on January 1, 2002, the Company ceased amortizing goodwill. The value of goodwill carried forward at the end of 2001 has been frozen at £2,274,000 and goodwill will be tested for impairment at least annually. The Company has completed the transitional impairment review upon adoption of SFAS 142 (January 1, 2002) and determined that there is no indication of impairment with respect to goodwill.

Impairment charges The Company reviews long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets are written down to their estimated fair value.

Revenue recognition Revenue consists of license fees received under the terms of license agreements with customers to enable them to use the Company's intellectual property (IP), which is customized to each customer's manufacturing process. The Company receives royalties on sales by the Company's customers of products containing ARM technology. It also supplies off-the-shelf software tools, bought-in boards and toolkits, training and consultancy services.

The Company primarily earns revenues from licensing its IP to leading electronics companies which in turn manufacture, market and sell microprocessors, ASICs and ASSPs based on the Company's architecture to systems companies for incorporation into a wide variety of end products. The Company's IP consists of software and related documentation which enables a customer to design and manufacture microprocessors and related technology and software. Most licenses are designed to meet the specific requirements of each customer and are generally not time limited in their application. In general, the time between the signing of a license and final customer acceptance is between six and 15 months. Upgrades or modifications to the licensed IP are not provided. Following customer acceptance, the Company has no further obligations under the license agreement. Revenue from per-use licenses is recognized when the product is accepted by the customer.

In accordance with SOP 81-1, "Accounting for performance of construction-type and certain production type contracts", when 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. Revenues are recognized only 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 that include 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 if no term is specified, beginning with the delivery of the first product.

In accordance with SOP 97-2, "Software revenue recognition", where agreements involve multiple elements that do not require "significant production, modification or customization", the entire fee from such arrangements has been allocated to each of the individual elements based on each element's relative fair value. Revenue for each element is then recognized when the revenue recognition criteria for that element is met.

In addition to the license fees, contracts generally contain an agreement to provide post contract support (support and maintenance) (PCS) which consists of an identified customer contact at the Company, and telephone or e-mail support. Revenue related to PCS is recognized based on vendor-specific objective evidence (VSOE), determined based on the price of PCS when sold separately. Revenue for PCS is recognized on a straight-line basis over the period for which support and maintenance is contractually agreed by the Company with the licensee.

Sales of boards and toolkits are recognized upon delivery. Where necessary, and in the circumstances permitted by SOP 97-2, the costs associated with providing post contract support have been accrued.

Services, such as consulting and training, which are not essential to the functionality of the IP, are accounted for separately based on VSOE. Revenue is recognized as services are performed and collectability is probable.

The excess of 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 Company'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 projects, which are typically of a short duration, is recognized when the service has been provided and all obligations to the customer under the consulting agreement have been fulfilled. For longer-term and more complex consulting projects, typically containing several project milestones, where significant modification to ARM core-based IP is required, revenue is recognized on a percentage-to-completion basis as milestones are achieved. This method approximates to percentage to completion based on labor inputs.

Restructuring costs Restructuring costs include the cost of redundancy payments to 98 employees and the cost of outplacement services.

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

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

Advertising costs All advertising costs are expensed in the period in which they are 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 Company retains significant rights to IP 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, 2002 were £199,000 (2001: £268,000; 2000: £186,000) and were netted against related research and development costs.

Pension costs The Company 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, PR China and Israel. The Company 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 Company for the years ended December 31, 2000, 2001 and 2002 were £1,160,000, £1,591,000, and £1,894,000 respectively.

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

Allowance for doubtful debts Allowance is made for doubtful debts following reviews of individual customer circumstances by management.

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.

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 Company'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 Company 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 Company's forward exchange contracts do not subject the Company 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 Company 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 Company 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.

From time to time, the Company enters into sales contracts denominated in a currency (typically US dollars) that is neither the functional currency of the Company nor the functional currency of the customer. In accordance with SFAS 133, "Accounting for derivative instruments and hedging activities", where there are uninvoiced amounts on such contracts, the Company carries such derivatives at fair value. The resulting gain or loss is recognized in the income statement under general and administrative costs. For the year ended December 31, 2002 the loss on exchange is £950,000 (2001: £nil; 2000: £nil).

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.

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

Earnings per share Basic earnings per common share is computed based on the weighted average number of ordinary shares. Diluted earnings per common share is computed by including potential common shares where the effect of their inclusion would be dilutive. The diluted share base for the year ended December 31, 2002, excludes incremental shares of approximately 19,608,000 (2001: 6,258,000; 2000: 274,000) 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 Company has elected to use the intrinsic value-based method to account for all its employee stock-based compensation plans, under the recognition and measurement principles of APB Opinion No. 25, "Accounting for stock issued to employees", and related interpretations. Stock-based employee compensation cost in respect of certain SAYE options (see below) of £56,000 is reflected in net income. No compensation cost is recorded in respect of the other stock option plans, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. 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 fully diluted 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.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for stock-based compensation", to stock-based employee compensation.

	Year ended December 31		
	2000 £000	2001 £000	**2002 £000**
Net income:			
As reported	29,377	34,002	**31,637**
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(8,265)	(11,610)	**(11,165)**
Add back: Total stock-based compensation expense determined under the intrinsic value-based method	–	–	**56**
Pro forma net income	21,112	22,392	**20,528**
Basic earnings per common share (pence):			
As reported	3.0p	3.4p	**3.1p**
Pro forma	2.2p	2.2p	**2.0p**
Diluted earnings per common share (pence):			
As reported	2.9p	3.3p	**3.1p**
Pro forma	2.1p	2.2p	**2.0p**

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 2002, 2001 and 2000: risk-free interest rate of 5.1% (2001: 5.1%; 2000: 6.0%); expected life of four years; 80% (2001: 79%; 2000: 74%) volatility; and no dividends.

The Company operates Save As You Earn (SAYE) schemes in the UK and an Employee Share Purchase Plan (ESPP) in the US. Options under these schemes are granted at a 15% discount to market price of the underlying shares on the date of grant. The UK SAYE schemes are approved by the Inland Revenue, which stipulates that the savings period must be at least 36 months. During the year, the Emerging Issues Task Force (EITF) reached a consensus, contained within EITF 00-23, that savings plans which have a savings period in excess of 27 months should be treated as compensatory. In accordance with EITF 00-23, which applies to new offers after January 24, 2002, the Company has recognized a compensation charge in respect of the UK SAYE plans offered since that date. The compensation charge is calculated as the difference between the market price of the shares at the date of grant and the exercise price of the option and is recorded on a straight-line basis over the savings period. The compensation charge recorded in 2002 is £56,000. The deferred compensation at December 31, 2002 was £313,000.

In addition, the EITF reached a consensus that an employer's offer to enter into a new SAYE contract at a lower price than an existing contract causes variable accounting for all existing awards subject to the offer. Variable accounting commences for all existing awards when the offer is made, and for those awards that are retained by employees because the offer is declined, variable accounting continues until the awards are exercised, are forfeited, or expire unexercised. New awards are accounted for as variable to the extent that previous higher priced options are canceled. The compensation charge recorded in 2002 as a result of these provisions is £nil. The number of options to which variable accounting applies is approximately 980,000.

Employee share ownership plans Treasury stock represents the cost of shares in the Company held by the Employee Benefit Trust (ESOP) and the 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, 2002. The market value of unearned shares at December 31, 2002, was approximately £240,000.

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.

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

Treasury stock held also includes £728,000 relating to 1,796,754 shares held by the Company'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 Company. No shares were purchased in 2002 or 2001. In 2000 2,042,999 shares were purchased as detailed below.

On March 13, 2000, and November 7, 2000, the Company provided £14,445,000 and £4,291,000 respectively 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 SAYE 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 £718,082, 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 2002, 220,846 shares (2001: 3,925,400) were allocated from the QUEST following the exercise of share options granted under the Company's SAYE schemes.

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.

Recently issued accounting standards In June 2002, the FASB issued SFAS No. 146 (SFAS 146), "Accounting for costs associated with exit or disposal activities". SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF 94-3, "Liability recognition for certain employee termination benefits and other costs to exit an activity (including certain costs incurred in a restructuring)". SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of the commitment to an exit plan. SFAS 146 states that a commitment to a plan, by itself, does not create an obligation that meets the definition of a liability. Therefore, SFAS 146 eliminates the definition and requirement for recognition of exit costs in EITF 94-3. It also established that fair value is the objective for initial measurement of the liability. SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Management does not expect the adoption of SFAS 146 to have a material effect on its consolidated financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others". FIN 45 requires the guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. It also elaborates on the disclosure to be made by a guarantor in its financial statements about its obligation under certain guarantees that it has issued and to be made in regard of product warranties. The initial recognition and movement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while the provisions of the disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. Management does not expect the adoption of FIN 45 to have a material effect on its consolidated financial statements.

In November 2002, the EITF reached a consensus on Issue 00-21, "Accounting for revenue arrangements with multiple deliverables". This Issue addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, the Issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. The provisions of this Issue are effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003, with early application permitted. Management is currently evaluating the impact that adoption of this Issue will have on its consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), "Consolidation of variable interest entities". FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated financial statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. FIN 46 applies to public enterprises as of the beginning of the applicable interim or annual period. Management does not expect the adoption of FIN 46 to have a material effect 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 and which did not contain statements under sub-sections 237(2) and (3) of the Companies Act) for the years ended December 31, 2000 and 2001 have been, and those for the year ended December 31, 2002, 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 Palmchip 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		
	2000 £000	2001 £000	**2002** **£000**
United Kingdom	32,568	46,394	**40,646**
Foreign	2,816	3,910	**4,776**
	35,384	50,304	**45,422**

The provision for income taxes consisted of:

	Year ended December 31		
	2000 £000	2001 £000	**2002** **£000**
Current:			
United Kingdom	4,968	14,502	**12,852**
Foreign	479	1,441	**1,791**
Total current	5,447	15,943	**14,643**
Deferred:			
United Kingdom	72	268	**(500)**
Foreign	488	91	**(358)**
Total deferred	560	359	**(858)**
Total provision for income taxes	6,007	16,302	**13,785**

Included in the provision for income taxes is a current tax charge of £754,000 (2001: £428,000; 2000: £nil) and a deferred tax credit of £60,000 (2001: charge of £146,000; 2000: charge of £617,000) 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 following a payment of £17,787,000 to the QUEST detailed in footnote 1. There were no payments to the QUEST in 2001 or 2002.

Total income tax expense differs from the amounts computed by applying the UK statutory income tax rate of 30% for 2002, 2001 and 2000 to income before income tax as a result of the following:

	Year ended December 31		
	2000 £000	2001 £000	**2002** **£000**
UK statutory rate 30% (2001: 30%; 2000: 30%)	10,615	15,091	**13,627**
Permanent differences arising on payment to QUEST	(5,331)	–	**–**
Permanent differences – other*	690	1,150	**186**
Differences in statutory rates of foreign countries	53	99	**115**
Other, net	(20)	(38)	**(143)**
	6,007	16,302	**13,785**

* Permanent differences comprise permanent adjustments, non-deductible stock option compensation and the UK research and development tax credit.

3 Income taxes continued

Significant components of the deferred tax assets are as follows:

	Year ended December 31		
	2000 £000	2001 £000	**2002 £000**
Fixed asset temporary differences	852	584	**1,193**
Temporary difference on available-for-sale securities	(458)	–	**–**
Non-deductible accruals and reserves	346	255	**519**
Losses carried forward	1,710	1,397	**544**
Total deferred tax assets	2,450	2,236	**2,256**
Valuation allowance	(1,710)	(1,397)	**(559)**
Net deferred tax assets	740	839	**1,697**

UK income taxes have not been provided at December 31, 2002, on unremitted earnings of approximately £10,142,000 (2001: £7,401,000; 2000: £4,641,000) 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 £518,000 (2001: £385,000; 2000: £232,000).

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. None of the loss carryforwards expires before 2018.

4 Earnings per share

	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

	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

	Year ended December 31, 2002		
	Income £	**Shares Number**	**Per share Amount**
Net income	**31,637,000**		
Basic EPS:			
Income available to common stockholders	**31,637,000**	**1,012,295,401**	**3.1p**
Effect of dilutive securities:			
Stock options		**8,465,051**	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	**31,637,000**	**1,020,760,452**	**3.1p**

4 Earnings per share continued

The following table summarizes the Company's reported results along with the adjusted amounts, as if the Company had adopted SFAS 142 and discontinued goodwill amortization as of January 1, 2000:

	Year ended December 31		
	2000 £000	2001 £000	**2002 £000**
Reported net income	29,377	34,002	**31,637**
Add back goodwill amortized	1,297	1,929	**–**
Adjusted net income	30,674	35,931	**31,637**
Basic earnings per share:			
Reported net income	3.0p	3.4p	**3.1p**
Goodwill amortization	0.1p	0.2p	**–**
Adjusted basic earnings per share	3.1p	3.6p	**3.1p**
Diluted earnings per share:			
Reported net income	2.9p	3.3p	**3.1p**
Goodwill amortization	0.1p	0.2p	**–**
Adjusted diluted earnings per share	3.0p	3.5p	**3.1p**

5 Business risks and credit concentration

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

The Company 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 and 2002 no customers accounted for more than 10% of accounts receivable. At December 31, 2000, one customer accounted for 10.4% of accounts receivable.

As of December 31, 2000, 2001 and 2002, the Company'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 Company 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 to research and development.

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 2002, the Company invested £1,500,000 in Superscape plc, an available-for-sale investment. In 2001, the Company disposed of two available-for-sale investments realizing a gain of £655,000.

In March 2000, the Company disposed of part of its shareholding in Palmchip Corporation, reducing its holding from 45.4% to 4.9%. The Company recognized a £512,000 profit on the sale of these shares.

Impairments during 2002 against unlisted investments held at the year end amounted to £826,000 (2001: £613,000).

7 Property and equipment

	December 31	
	2001 £000	**2002** **£000**
Owned buildings	190	**190**
Construction in progress – leasehold improvements	75	**–**
Leasehold improvements	11,863	**18,763**
Computers	9,973	**10,811**
Software	24,370	**31,095**
Fixtures, fittings and motor vehicles	2,819	**3,101**
	49,290	**63,960**
Less: accumulated depreciation	(26,622)	**(38,239)**
Property and equipment, net	22,668	**25,721**

Depreciation charged to income for the years ended December 31, 2000, 2001 and 2002 was £6,246,000, £9,327,000 and £12,463,000 respectively.

8 Intangible assets

	Goodwill 2001 £000	Patents 2001 £000	Licenses 2001 £000	Total 2001 £000	**Goodwill 2002 £000**	**Patents 2002 £000**	**Licenses 2002 £000**	**Total 2002 £000**
At cost	5,594	7,513	3,877	16,984	**5,594**	**8,196**	**4,049**	**17,839**
Less: accumulated amortization	3,320	–	1,325	4,645	**3,320**	**1,595**	**2,507**	**7,422**
Net	2,274	7,513	2,552	12,339	**2,274**	**6,601**	**1,542**	**10,417**

Goodwill, being the difference between the fair value of the consideration and the fair value of the assets and liabilities assumed, arose on purchase 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.

Until the adoption of SFAS 142 on January 1, 2002 (see footnote 1), goodwill was being 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. In accordance with SFAS 142, goodwill is no longer amortized, and is tested for impairment at least annually.

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

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

The estimated amortization expense of intangible assets in each of the next five years is set forth below:

	£000
2003	2,617
2004	1,881
2005	1,862
2006	1,738
2007	45

9 Shareholders' equity

Share capital There was a share split 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.

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 one 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 options are exercisable one to five years after their issue. Under both of these 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.

In 1998, the Company set up two savings-related share option schemes for all employees and executive directors of the Company. 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 2000, 2001 and 2002 for all employees and executive directors of the Company, which have the same characteristics as those schemes set up in 1998.

Option activity is summarized as follows:

	Outstanding options	
	Shares Number	Weighted average exercise price £
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
Granted in year	10,081,501	2.290
Lapsed in year	(3,269,030)	1.965
Exercised in year	(7,211,670)	0.691
Balances, December 31, 2002	**35,051,349**	**2.557**

The weighted average grant-date fair value of options granted during 2002 was £2.34 for executive options and £1.83 for sharesave options.

The weighted average exercise price of options exercisable at December 31, 2002 was £1.71 (December 31, 2001: £1.03).

9 Shareholders' equity continued

The following options over ordinary shares were in existence at December 31, 2002:

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	Exercisable at December 31 2002
320,000	0.02	3.5 years	1999 – 2006	**320,000**
600,000	0.02	0.5 years	1999 – 2003	**600,000**
725,500	0.026	4.2 years	2000 – 2007	**725,500**
8,000	0.026	1.3 years	2000 – 2004	**8,000**
80,000	0.0425	1.4 years	2000 – 2004	**80,000**
70,000	0.0625	1.5 years	2000 – 2004	**70,000**
150,000	0.0625	1.8 years	2000 – 2004	**150,000**
230,000	0.0625	2.0 years	2000 – 2004	**230,000**
660,000	0.1125	5.2 years	2001 – 2008	**660,000**
55,036**	0.1125	0.2 years	1999 – 2003	**55,036**
134,309**	0.3875	0.4 years	1999 – 2003	**134,309**
115,000	0.3875	2.4 years	2001 – 2005	**115,000**
125,000	0.5275	5.6 years	2001 – 2008	**125,000**
54,322**	0.5275	0.6 years	1999 – 2003	**54,322**
51,000	0.405	5.8 years	2001 – 2008	**51,000**
34,550**	0.405	0.8 years	1999 – 2003	**34,550**
2,909,507	1.224	6.2 years	2002 – 2009	**2,909,507**
1,489,869**	1.224	1.2 years	2000 – 2004	**763,619**
4,986,040	1.224	3.2 years	2002 – 2006	**4,986,040**
158,259	1.338	6.3 years	2002 – 2009	**158,259**
41,254**	1.338	1.3 years	2000 – 2004	**27,504**
42,740	1.338	3.3 years	2002 – 2006	**42,740**
75,490	1.765	6.6 years	2002 – 2009	**75,490**
40,002**	1.765	1.6 years	2000 – 2004	**27,502**
26,010	1.765	3.6 years	2002 – 2006	**26,010**
91,570	4.26	6.9 years	2002 – 2009	**91,570**
76,680	4.26	3.9 years	2002 – 2006	**76,680**
121,250	7.738	–	2003 – 2010	**–**
52,500**	7.738	2.1 years	2001 – 2005	**26,250**
70,000	7.738	–	2003 – 2007	**–**
80,465	6.136	–	2003 – 2010	**–**
10,000**	6.136	2.3 years	2001 – 2005	**5,000**
36,035	6.136	–	2003 – 2007	**–**
50,000**	6.27	2.3 years	2001 – 2005	**25,000**
346,763	6.155	–	2003 – 2010	**–**
794,000**	6.155	2.4 years	2001 – 2005	**397,000**
2,689,555**	6.155	4.4 years	2001 – 2007	**672,388**
24,250**	6.70	2.6 years	2001 – 2005	**12,125**
162,500**	6.70	4.6 years	2001 – 2007	**81,250**
145,750**	6.33	2.8 years	2001 – 2005	**72,875**
252,500**	6.33	4.8 years	2001 – 2007	**126,250**
83,000**	4.43	3.1 years	2002 – 2006	**20,750**
436,500**	4.43	5.1 years	2002 – 2008	**218,250**
590,521	3.35	–	2004 – 2011	**–**
1,305,900**	3.35	3.4 years	2002 – 2006	**326,475**
3,760,529**	3.35	5.4 years	2002 – 2008	**940,132**
62,909†	3.815	–	2008 – 2008	**–**
58,813	2.84	–	2004 – 2011	**–**
28,000**	2.84	3.6 years	2002 – 2006	**7,000**
20,822**	2.84	5.6 years	2002 – 2008	**5,205**
139,000	3.75	–	2004 – 2011	**–**
44,750**	3.75	3.8 years	2002 – 2006	**11,187**
51,000**	3.75	5.8 years	2002 – 2008	**12,750**
62,500**	3.145	–	2003 – 2007	**–**
176,250**	3.145	–	2003 – 2009	**–**
1,072,098	2.465	–	2005 – 2012	**–**
4,294,627**	2.465	–	2003 – 2009	**–**
406,896†	2.465	–	2005 – 2009	–
1,500,675**	2.465	–	2003 – 2007	**–**
223,515**	2.1475	–	2003 – 2009	**–**
128,500**	1.505	–	2003 – 2007	**–**

9 Shareholders' equity continued

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	**Exercisable at December 31 2002**
378,250**	1.505	–	2003 – 2009	–
68,750**	0.425	–	2003 – 2007	–
120,000**	0.425	–	2003 – 2009	–
3,500**	0.5725	–	2003 – 2007	–
35,000**	0.5725	–	2003 – 2009	–
179,400*	0.2445	–	2003 – 2003	–
11,240*	1.099	–	2004 – 2004	–
26,481*	5.65	–	2003 – 2003	–
4,896*	5.65	–	2005 – 2005	–
203,480*	3.069	–	2004 – 2004	–
28,366*	3.069	–	2006 – 2006	–
22,349*	3.069	–	2003 – 2003	–
905,064*	1.82537	–	2005 – 2005	–
242,922*	1.82537	–	2007 – 2007	–
189,140*	1.82537	–	2004 – 2004	–
35,051,349				**15,557,525**

* 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.

At December 31, 2002, the Company had three share option plans and seven savings-related share option schemes. The Company applies APB Opinion No. 25 and related interpretations in accounting for its plans.

10 Commitments and contingencies

The Company 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, 2002, are as follows:

Years ending December 31	Operating leases £000
2003	5,149
2004	4,791
2005	3,054
2006	2,250
2007	2,110
Thereafter	17,682
Total minimum lease payments	35,036

Rental expense under operating leases totaled £2,746,000, £3,101,000 and £5,199,000 for the years ended December 31 2000, 2001 and 2002 respectively.

The Company has an obligation, if certain criteria are met, to make a $3,000,000 investment, representing a minority holding in a fabless semiconductor company set up to create and sell ARM core-based microprocessor cores to be licensed from ARM.

In 2002, a lawsuit was filed against the Company claiming that the Company's Jazelle technology for Java acceleration infringes a US patent. The Company is confident that its products do not infringe the patent cited in the lawsuit or any other patents, is defending the action vigorously and believes that the matter could be concluded quickly.

11 Geographic and segment information

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

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

	Year ended December 31		
	2000 £000	2001 £000	**2002 £000**
Revenues (by market destination):			
Europe	20,616	27,103	**26,731**
US	55,233	72,271	**67,087**
Japan	18,007	33,548	**38,294**
Asia Pacific excluding Japan	6,874	13,352	**18,810**
Total revenues	100,730	146,274	**150,922**

The Company's exports from the United Kingdom were £87,096,000, £128,303,000 and £135,713,000 for the years ended December 31, 2000, 2001 and 2002 respectively.

	Year ended December 31		
	2000 £000	2001 £000	**2002 £000**
Revenues (by origin):			
Europe	90,248	131,136	**137,747**
US	5,608	8,431	**7,288**
Asia Pacific	4,874	6,707	**5,887**
Total revenues	100,730	146,274	**150,922**
Long-lived assets, including deferred income taxes:			
Europe	23,588	35,626	**38,044**
US	4,023	3,608	**3,751**
Asia Pacific	77	167	**269**
Total long-lived assets	27,688	39,401	**42,064**

In 2002 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 Company's financial instruments are as follows:

	Year ended December 31					
	2000		2001		**2002**	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000	**Carrying amount £000**	**Fair value £000**
Cash and cash equivalents	75,266	75,266	104,467	104,467	**130,304**	**130,304**
Accounts receivable	18,913	18,913	24,809	24,809	**20,516**	**20,516**
Foreign currency contracts	551	551	355	355	**1,061**	**1,061**
Embedded derivatives	–	–	–	–	**(950)**	**(950)**

Report of independent accountants/US GAAP

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, changes in shareholders' equity and of cash flow present fairly, in all material respects, the financial position of ARM Holdings plc and its subsidiaries at December 31, 2002 and 2001 and the results of their operations and their cash flows for the years ended December 31, 2002, 2001 and 2000 in conformity with accounting principles generally accepted in the United States of America. 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 audits. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audits 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 LLP

PricewaterhouseCoopers LLP Chartered Accountants
Cambridge, England
28 February 2003

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