ARM®

Annual report and accounts 2003

connected

Contents

ARM designs technology that lies at the heart of advanced digital products.

We have a strong record of creating innovative products and industry standards, supported by a broad, connected community of partners. We develop and license our architecture to leading electronics companies, enabling them to develop reliable total system solutions.

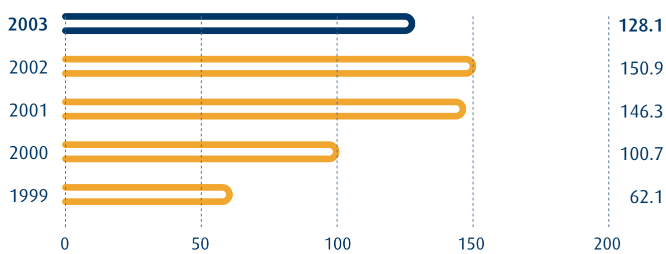
The ARM architecture delivers high-performance, low-cost, power-efficient processors, data engines, peripherals, software and tools. These solutions are used in a wide range of applications, including in the automotive, consumer entertainment, digital imaging, mass storage, networking, security and wireless industries.

Whether at home, in the office or on the move, you are likely to be connected using a product which has ARM technology at its core.

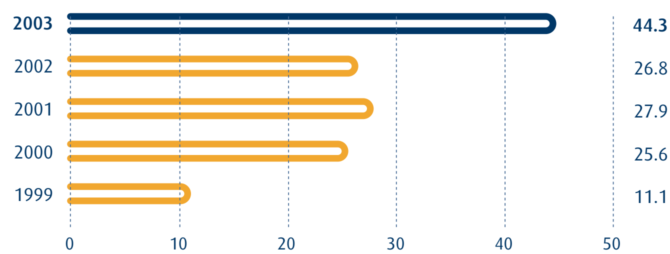
ARM at a glance

- Total revenues of £128.1 million in 2003 compared with £150.9 million in 2002
- Our partners shipped a total of 782 million units in 2003 based on ARM technology (an increase of 71%)
- R&D expenditure maintained at high levels giving rise to introduction of further innovative products

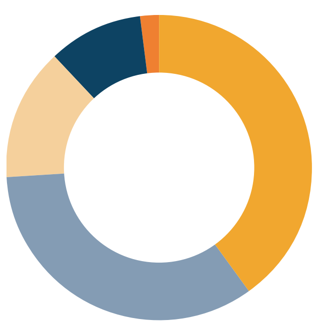
Total revenues (£m)



Royalty revenues (£m)

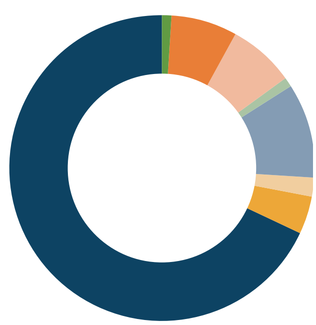


Revenue analysis (%)



Licensing	40%
Royalties	34%
Development systems	14%
Support, maintenance and training	10%
Consulting	2%

Royalty units (%)



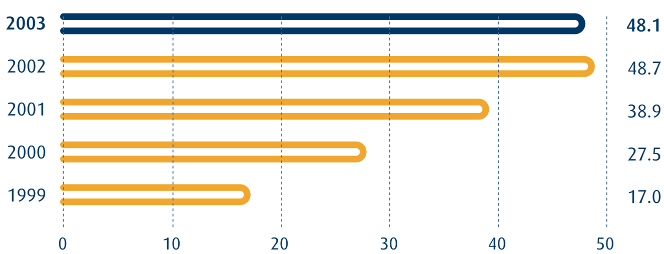
Automotive	1%
Consumer entertainment	7%
Imaging	7%
Microcontrollers	1%
Networking	10%
Secure	2%
Storage	4%
Wireless	68%

Licence revenues by product (%)

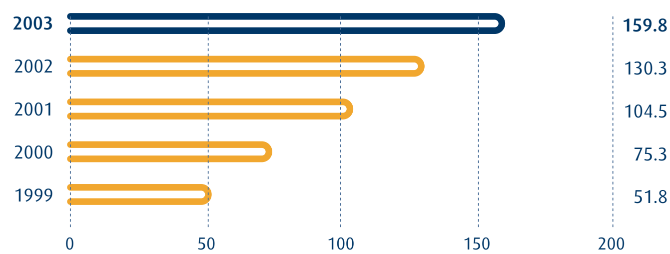
ARM7™ family	18%
ARM9™ family	31%
ARM10™/ARM11™/architecture	33%
Non-core licensing	18%

- Additional core (ARM926EJ™) now available in the Foundry Programme
- Cash and short-term investments of £159.8 million at 31 December 2003, an increase of £29.5 million in the year
- Annual dividend introduced reflecting confidence in future cash flows

Research and development expenditure (£m)



Net cash balance at year end (£m)



Geographic revenue by market destination

United States 51%

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

Asia Pacific 31%

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

Europe 18%

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

2003 was a year of stable quarter-on-quarter progress, continued technological innovation, and one in which the ARM® architecture gained increasing global acceptance

Results and dividend

The decisions we took in the fourth quarter of 2002 to reduce our cost base, but also to maintain our high level of research and development expenditure throughout the protracted industry downturn enabled us, during the year, to introduce a number of new products based on innovative technologies and to strengthen our position in becoming the architecture for the digital world.

Although our full year 2003 revenues were down on the previous 12 months, our revenues in 2003 increased from the first quarter onwards. On total revenues of £128.1 million, we earned profit before tax of £23.2 million (after adjusting for the cost of settlement of the dispute with Herodion of £6.4 million). Good cost control and working capital management enabled us to convert this into net cash generation of £29.5 million*.

This strong cash generation, together with our confidence in the Group's long-term prospects, enabled us to continue to make significant investments in technological innovation, both organic and through a "bolt-on" strategic acquisition.

* Net cash generation is the movement in cash and short-term investments as per the balance sheets at the beginning and end of the year.

The board also decided at the end of 2003 to initiate the payment of an annual dividend. We see a return of cash to shareholders through a dividend as part of a package of measures to make the best use of the business's cash resources. It is the board's intention to increase the dividend over time, taking into account the opportunity for continued investment in the business and the Group's underlying operational performance.

The market

Activity in the semiconductor industry gradually increased as 2003 progressed, giving rise to improving confidence among our partners, particularly in respect of the volume of products shipped. However, tight financial control by our partners continues to be exerted and it is expected that improvements in licensing revenue will occur gradually during 2004. In the meantime, the expansion of our existing family of products, together with new products introduced in 2003, is expected to contribute to a long-term trend of improving licensing revenue.

It is encouraging to see that our partners shipped so many ARM core-based products in the year: 782 million units, 71% more than in 2002. This gives us confidence that we are providing our semiconductor partners with the right technologies to meet the expectations of their customers – the Original Equipment Manufacturers (OEMs). It also demonstrates that consumers are more readily embracing the digital world.

Geographic expansion

ARM's business is increasingly global. In 2003, the geographic source of our revenues illustrated the global reach of the semiconductor industry as well as our role at its heart: 51% of full-year revenues emanated from North America, 31% from Asia Pacific, and 18% from Europe.

The balance of world trade is, however, shifting. China is becoming an increasingly influential player; what was traditionally an agrarian society is becoming an industrial one, which means that its need for electronics to use in goods that it exports, as well as in those which it consumes domestically, is increasing rapidly.

Currently most of the chips which are used in China are bought from our partners and are designed around our intellectual property (IP), but we are establishing local relationships in China as the country's high-technology industry matures and its companies begin to develop their own IP. We have been working

with companies in China for a number of years: we set up our first office, in Shanghai, in July 2002. In 2004, we plan to open a second office, in Beijing.

During 2003, we signed seven licences in China, not only with semiconductor companies but also with foundries and universities. Watertek became the first ARM Approved Training Centre in China in January; we extended our University Programme when Southeast University licensed the ARM7TDMI® core in May, and when Shanghai Jiaotong University licensed the ARM922T™ core in December; we signed our first licensing deal with a Chinese government-supported organisation, Shanghai ICC, in May; in July we extended our Foundry Programme when we signed an agreement with SMIC; Datang licensed the ARM946E™ microprocessor core in September, and in December, Shanghai Fudan Microelectronics licensed the ARM7TDMI core.

Many entrepreneurial and innovative ventures are emerging in other markets. ARM is working to help these companies as they seek the right technology to achieve time-to-market and time-to-volume advantage. We have signed a number of licences in Israel within the last two years and expect to announce more licences during 2004. In addition, we are increasingly active in India, where many engineers have experience of working with our technology.

People

We made a conscious decision at the outset of 2003 that, excluding acquisitions, we would keep our headcount stable throughout the year. Our employees responded magnificently to the challenge and achieved a lot while under tight cost constraint. We were delighted to welcome 25 new employees to ARM with the acquisition of Adelante Technologies N.V. (now ARM Belgium N.V.) in July 2003.

Board changes

Lawrence Tesler will be retiring from the board at the Annual General Meeting on 26 April 2004, having served two three-year terms as a non-executive director. With his strong technology background and industry experience, he has made a significant contribution over the past six years, which the board has greatly appreciated.

It is intended that Jeremy Scudamore who is CEO of Avecia Group (formerly the specialty chemicals business of Zeneca) be appointed as a non-executive director of the Company immediately following the Annual General Meeting on 26 April 2004. He has considerable international business experience and will bring a broad range of skills to the board that extend beyond the semiconductor industry.

Current trading and prospects

We enter 2004 with confidence. Our business continues to make good profits and to generate cash throughout the toughest downturn that our industry has witnessed for many years. We continue to invest in innovation and in products for the future. We believe that, as the industry emerges from the downturn, our competitive position is stronger than it was before.

The number of new products available for licensing in 2004, and the momentum behind our royalty revenues, give us confidence that this will be another successful year and that we will enjoy a return to revenue growth. Many challenges lie ahead, however, and the continuing weakness of the US dollar against sterling will have an impact.

Notwithstanding these challenges, we are confident that the platform we have established over the past 13 years, together with the passion and commitment of our employees, and the work of our partners, leave us well placed to benefit as the digital world gathers pace.

Robin Saxby

Sir Robin Saxby Chairman

During 2003 we continued to progress our business by developing our technology and products. It was a year of stabilisation, but one in which we achieved our major business goals

The global business climate improved in 2003, particularly towards the end of the year. As a result, the technology industry appears to have shaken off much of the uncertainty which characterised the first two years of the new decade and, while we cannot be sure how long it will take for these improvements to result in increased licensing activity, the change in the economic environment is welcome.

The improvement in the economy, combined with the adjustments to our cost base made in the fourth quarter of 2002, enabled us to improve quarterly revenues throughout 2003 and to achieve strong net cash generation each quarter. Our decision to maintain a high level of investment in research and development (R&D) during the industry downturn enabled us to introduce a number of new products. These are already driving licence revenue and are underpinning our confidence in our ability to increase revenue during 2004.

Gradual increases in quarterly revenue and tight cost control gave rise to improving margins (excluding one-off legal settlement costs) as the year progressed. The weakness of the dollar had an impact on revenue growth, particularly in the second half, but 2003 was still a year of robust financial performance.

Licensing, product development and new technology

Licensing is fundamental to our business: it drives royalties and underpins our future profitability. Activity gradually picked up in the third quarter and continued into the fourth. In 2003, we signed a total of 51 licences for microprocessors; of these, 25 were multi-use licences and 26 per-use licences. We signed licences with 26 new companies, bringing the total number of semiconductor partners to 128. Of the 26 new partners, seven took multi-use licences and 19 per-use licences.

2003 was another busy and rewarding year in terms of our product development. Market demand for microprocessor solutions that offer increased performance, security and power efficiency continues.

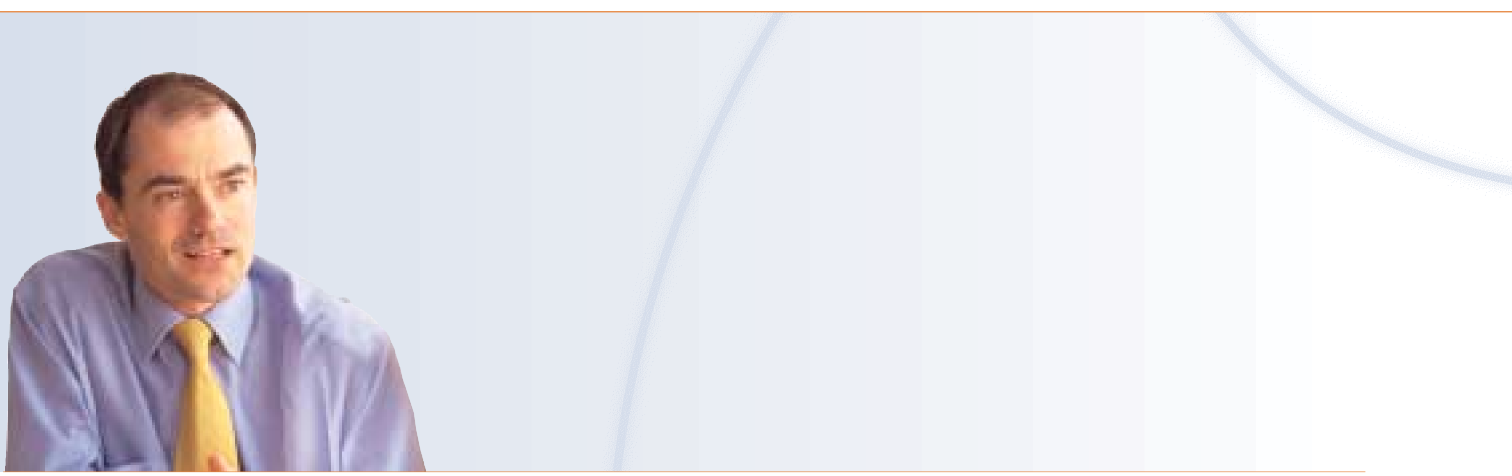
We introduced a number of new products during the year which incorporate new technology features, including the TrustZone™ security extension, the Thumb®-2 core technology for improved code density and Intelligent Energy Manager (IEM) hardware and software for low-power consumption. These underpin the opportunities for licensing in 2004 and beyond.

TrustZone technology will greatly improve the security of mobile devices, which is a major concern for handset suppliers and service providers. Our IEM technology is continuing our relentless push to improve the power efficiency of battery-operated devices; and we are taking significant steps in enabling the development of complex and efficient solutions, partly through our work with NEC in Symmetrical Multi-Processing (SMP).

These, together with other technologies announced in 2003, are complementary to the growing range of our cores.

In October, we launched two new ARM11 family microprocessors, the ARM1156T2-S™ core and the ARM1176JZ-S™ core, which include a number of these new features; they are available for licensing now for delivery in mid-2004. We delivered the first ARM11 core family-based product just over a year ago and are encouraged by the rate at which this technology is being adopted. So far, our partners have taken a total of ten licences.

In December 2003, we announced a new ARM9 family core, the ARM968E-S™ core, for deeply embedded applications. Our smallest, lowest-power, synthesizable ARM9E™ family core provides an ideal solution for networking



applications, but will also be appropriate for many applications in the automotive, consumer entertainment and wireless sectors.

These new cores represent significant extensions to our range. At the same time, we are working on our next-generation architecture. We signed our first lead partner for this technology in the third quarter of 2003.

The Foundry Programme

The introduction of the ARM926EJ core to our Foundry Programme, which continues to provide an excellent entry point for companies which are licensing our technology for the first time, will help to maintain the momentum in the programme. Per-use licensees are now able to have this product manufactured by two of our foundry partners, TSMC and UMC.

Royalty revenues

Substantial licensing in recent years resulted in a much higher number of ARM Powered® devices being shipped than in 2002. Our partners shipped 782 million ARM Powered devices in 2003, at a value of £44.3 million, an increase of 71% on 2002's record of 456 million units.

The fact that volumes increased across all markets demonstrates that our core-based designs are increasingly the architecture of choice. There was also a significant increase in the number of partners shipping ARM Powered devices – from 43 at the end of 2002, to 60 by the end of 2003.

Part of this success can be attributed to the improved economy but more important, we believe, is the fact that more of our partners began shipping more ARM Powered products, including an increasing proportion based on our newer ARM9 family cores.

We have traditionally been very strong in the wireless market, but in recent years have begun to mirror that success elsewhere and, as a result, have improved the balance and stability of our business. Unit shipments in other markets are now growing at the same rate as those in the wireless market.

Patent portfolio

The protection of our IP and the growth of our patent portfolio are key priorities for the business. In 2003, we filed twice as many patents as in 2002 and we anticipate that the rate of filing will continue to increase in 2004.

It is imperative that we defend our IP vigorously and, in that context, we were encouraged that the partial summary judgement ruling in Nazomi's case against us for alleged patent infringement found in our favour. The partial summary judgement ruled that products using the current commercial design of the ARM Jazelle® technology do not infringe Nazomi's patent. Nazomi has appealed against the ruling, but we are confident that the original ruling will be upheld.

In March 2004, we settled all outstanding issues with Herodion (picoTurbo Inc.'s successor entity) relating to the out-of-court settlement of the patent lawsuit against picoTurbo in December 2001. Following the findings of an arbitration panel established to resolve the issues and subsequent discussions between the parties, ARM agreed to pay £6.4 million as part of the settlement agreement. This amount has been charged to the profit and loss account in 2003.

The future

Our commitment to R&D keeps us ahead of the competition. We maintained high levels of investment in innovation in 2003, even though it was a tough year, and the fruits of our labours are being realised with the introduction of our new technologies. While better economic conditions should help us to progress, much of the improvement we expect in 2004 can be attributed to factors which are in our control, such as the availability of a number of new products for licensing.

We fully expect to build on our recent successes in the coming year.

Warren East.

Warren East Chief Executive Officer

ARM is connected – to its partners, its customers, its suppliers, its shareholders, to governments, to education, to standards bodies, and to its employees. It also enables organisations and consumers to be connected to one another and to innovative technology, and to transmit information around the world – from home, from work or on the move.

ARM Connected Community

In the 13 years since we founded the Company, we have developed a unique partnership business model which, in 2003, we formalised when we created the ARM Connected Community. Membership of the community is open to any company that has a product that uses or complements our technology, or one which helps in the design of ARM Powered devices.

These members include semiconductor and systems companies that develop our ideas and innovations into digital products; suppliers of embedded operating systems (OS) and development environments; providers of application software; vendors of electronic design automation (EDA) tools, which enable designers to test and verify circuits before beginning production; vendors of silicon based on our system platforms, which provide the tools and methodologies which enable our partners to differentiate their end products; and tools developers, which supply hardware and software solutions for designers to implement our architecture.

We now have 128 semiconductor partners; 50 development tools partners; 30 OS partners; and 40 technology partners, which include TransDimension, for USB on the go; Superscape, for Swerve i3D applications; SafeNet, for wireless security; and Imagination, for MBX graphic acceleration.

Membership of the Connected Community brings a range of benefits. The most obvious is that members are connected to ARM, which is widely regarded as one of the UK's most successful technology companies and one which invests more than one-third of its income in R&D. Many members of the Community are aligning themselves with the ARM brand to demonstrate that connection. Other benefits include access to a range of companies that can provide services or components, sales leads and opportunities to network and to take part in promotional programmes. Hundreds of companies around the world now belong to this global community that provides solutions, from design to manufacture, for products based on our architecture.

Connected to employees

We value our people. Our investment in training and retaining them enables us to maintain our culture of continuous innovation.

Our policies on employment are set out in more detail in the corporate social responsibility report on page 21 of this document.

Connected to sharing information

Our IP is a vital element in products which enable consumers to share and store information, access and enjoy media content, and send and receive images, from home, from work or on the move, and to do it all securely.

Our architecture bridges the gap between individuals and the information-rich outside world. It is at the heart of the wireless market. It powers PDAs and more than 75%

connected community

Membership of the ARM Connected Community brings a range of benefits, which includes being connected to what is widely regarded as one of the UK's most successful technology companies

of the world's mobile telephones; it enables consumers to use applications such as the Nintendo Game Boy Advance and set-top boxes; it plays a crucial role in creating a secure infrastructure to protect personal information in digital products.

It is also popular with the automotive industry because it is used by a wide range of partners and thereby helps to simplify the supply chain; and it is facilitating the progression of microcontrollers (MCUs), used in domestic products such as washing and dishwasher machines, and in industrial controllers, from 4- and 8-bit to 32-bit solutions, which can deliver more flexibility and greater performance.

Connected to performance

In recent years, the demand for technology to be more efficient and, indeed, to do more has increased beyond the imagination even of H G Wells. We already expect our washing machines and dishwashers to be able to "read" how big and how dirty the load is; our cars to lock by remote control; our video and DVD machines to record when we are out; our cameras to produce instant images; and our mobile telephones to be able to send and receive voice and text data, e-mails and images. There is no doubt that manufacturers will continue to be under pressure to accommodate more functions into their products.

Every benefit that is built into a system brings, however, its challenges: these are principally power consumption and security, and we have been paying particular attention to both.

Power consumption has always been high on our agenda. Delivering more compute power while, at the same time, reducing

ARM CONNECTED

A growing partnership

- 128 semiconductor partners
- 50 development tools partners
- 30 operating systems partners
- 40 technology partners

power consumption brings benefits to a wide range of applications. Achieving this continues to be a driving force in our research and development activities, but extra functions on, for example, a mobile telephone simply devour battery power and we saw the need to find a means of controlling this.

During the year we launched our Intelligent Energy Manager (IEM) product, which is incorporated into our ARM1176JZ-S core. IEM technology is what is called a closed-loop control system: it monitors how much power the application needs and adjusts the battery power accordingly. The principle is much the same as installing a thermostat on a central heating system. By eliminating waste, IEM technology enables equipment to be "always on" without sacrificing usage time.

We made further strides in improving our signal processing IP portfolio when we acquired Belgium-based Adelante Technologies N.V. in July 2003. The team, now ARM Belgium N.V., is established as our data engine business and is already playing an important part in our future.

The market for ever-more sophisticated multimedia and networking communications continues to increase, but the rapidly-changing demands on the technology cannot always be met efficiently with conventional signal processing. In collaboration with other ARM businesses, ARM Belgium is developing OptimoDE™, which comprises a configurable data engine (signal processor) solution with related IP and tools. OptimoDE technology will be used in systems together with our existing cores and other system IP.

The configurability of OptimoDE technology enables designers to match signal processing

at the heart

The ARM architecture is at the heart of advanced digital products: it provides access to information at home, in the office or on the move.

solutions to the needs of a specific application or algorithm. This provides excellent processing in a flexible solution which meets the power and cost constraints set by the new generation of algorithms. In addition to high performance, OptimoDE technology offers low power and a fast route to implementation.

Connected to security

Security is an issue for a wide range of people and organisations, from manufacturers, service providers and network operators to content creators and end users; and for a wide range of products, from smart cards, set-top boxes and mobile telephones to cars and household appliances. Hackers and viruses that corrupt computers can equally corrupt other devices and the more applications there are on, for example, a mobile telephone, the more vulnerable it is to attack. Without the owner's knowledge, a mobile telephone could send thousands of text messages or voice calls to other mobiles and, by doing so, could not only corrupt or contaminate the other devices, but could also overload the network to the point of collapse. This clearly has huge financial implications for everyone concerned.

Content providers, such as movie companies, could be faced with unauthorised distribution – a problem the music industry has contended with for some time – and car manufacturers need to be able to protect the computer systems which control vehicles' operating and safety systems.

Our engineers came up with an innovative idea that we were able to convert into a new product: TrustZone technology. This creates a barrier – a secure area within a processor and the system around it within which only designated, secure tasks can be performed.

Designers have historically tried to implement secure systems by adding "logic" to a core design; this is complicated, costly and, in the end, the product is never truly protected. Our approach results in a reliable and secure system which is integrated in the core, is cost effective and resistant to software hacks.

In November, we expanded our smart card portfolio when we launched our SecurJC™ technology. The increasing demand for smart cards has created a need for products that are secure as well as high performance. Our SecurJC technology is appropriate for any type of smart card, including SIM cards. It enables developers of cards based on JavaCard technology to focus on application design by eliminating what is usually the most time-consuming element of the design cycle – the need to redevelop an entire implementation.

Connected to software

We have always maintained the backwards compatibility of software so that a partner's investment in our technology is protected; equally, in addition to creating innovative new products, we upgrade and improve existing technology.

In 1995, we introduced our popular Thumb solution, a breakthrough technology that enabled software developers to create highly compact code to run our architecture, but the problem of providing high performance at low cost, combined with long battery life, continued. In May 2003, we launched Thumb-2 core technology, an extension of our 32-bit architecture. Thumb-2 technology improves performance and saves power by enabling system makers to condense software to fit into a smaller memory device. Because the code delivers more performance, the processor

Enabling technologies

- Coresight
- Intelligent Energy Manager
- OptimoDE
- SecurJC
- Swerve
- Thumb-2
- TrustZone

can be run at a lower frequency, but still achieve the same amount of work.

Our significant presence in the wireless industry has enabled us to work with a number of leading companies, to facilitate the availability of high-quality 3D games (which have been accessible on PCs since 1995) on wireless devices. In May 2003, we launched our Swerve solution, which we developed in collaboration with Superscape Group plc. The Swerve Client engine is designed for small screens and incorporates technology that saves memory and download time, making it ideal for applications such as mobile telephones and PDAs. It opens up a new range of applications for consumers. It specialises in facilitating interactive 3D technology and enables designers and programmers to create content quickly without needing detailed knowledge of techniques such as 3D rendering.

Three of the world's top five mobile telephone manufacturers have chosen to incorporate Swerve technology into their handsets.

Software is becoming increasingly complex: chips in today's products incorporate multiple microprocessors and tens of megabytes of program code to implement many more functions in a single device.

To help OEM product developers create competitive products, we developed Coresight™ low-cost debug and trace technology which gives visibility into the operation of highly complex embedded products. This enables developers to meet the imperatives of creating reliable, high-performance products and of bringing them to market quickly.

Connected to Foundry partners

The Connected Community also includes our Foundry Programme partners. We created this programme to give smaller semiconductor manufacturers, which do not have their own facilities to fabricate silicon (known as fabless companies), access to our technology. By licensing foundries to provide a range of process technologies we are able to protect our IP while, at the same time, making it widely available.

During the year, we launched our new ARM926EJ Prime Starter Kit through the Foundry Programme; this provides an even more cost-effective way for these smaller companies to move quickly from concept to finished product. The ARM926EJ Prime Starter Kit enables fabless companies to license a combined package comprising the ARM926EJ core and the PrimeXsys Platform, together with the Embedded Trace Macrocell™ solution.

Connected to the future

Innovation has always been, and will continue to be, the key to ARM's success. R&D forms a large part of our work schedule and our constant quest for the next "killer application" frequently involves us in forming alliances with other industry-leading companies.

In October 2003, we announced that, in collaboration with NEC Electronics, we are developing central processing unit (CPU) cores based on symmetric multiprocessor (SMP) technology. SMP technology is about putting a number of multiple processors on a single chip. If an application needs a great deal of power, the workload can be shared across the processors but, as in IEM technology, it is scaleable: if three processors are needed to complete the task, that is what is used; if

setting the standard

ARM's Connected Community gives our partners access to standard and proven designs. We focus on protecting their investment in technology; we also create innovative products which will set the standard for the future

eight are needed, they are available. It's about using as much resource as is needed to create exactly the right solution.

We have always been evangelists for digitalisation – we believe it delivers greater opportunities, efficiency and security – and consumers' demands for increasingly advanced digital products are now driving the semiconductor market.

These, and other, developments emphasise our culture of innovation, make the best use of our partnership model and ensure that the ARM Community continues to be connected to the future, for everyone's benefit.

Investing in the future

- More than one-third of revenue invested in R&D
- 676 patent applications, 290 granted
- Leadership role in establishing standards

Directors and advisers

Sir Robin Saxby | Warren East | Tim Score | Tudor Brown | Mike Inglis

Sir Robin Saxby age 57
Chairman
Sir Robin Saxby joined ARM in February 1991 as Chairman, President and Chief Executive Officer. He relinquished his roles as President and CEO in October 2001. Before joining ARM, he was with European Silicon Structures SA (ES2) where he was Vice President, Northern Europe; Managing Director, ES2 Limited; and President of US2, ES2's US affiliate. He was previously with Motorola Semiconductors and with Henderson Security Systems Limited. He has also served as Chairman of the EU panel, Open Microprocessor Initiative Advisory Group, which advised on collaborative R&D activity. In 2000, he was awarded an honorary doctorate DEng from Liverpool University and was appointed a visiting professor to the university's department of electronics. 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 42
Chief Executive Officer
Warren East joined ARM in 1994. He set up ARM's consulting business and was 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.

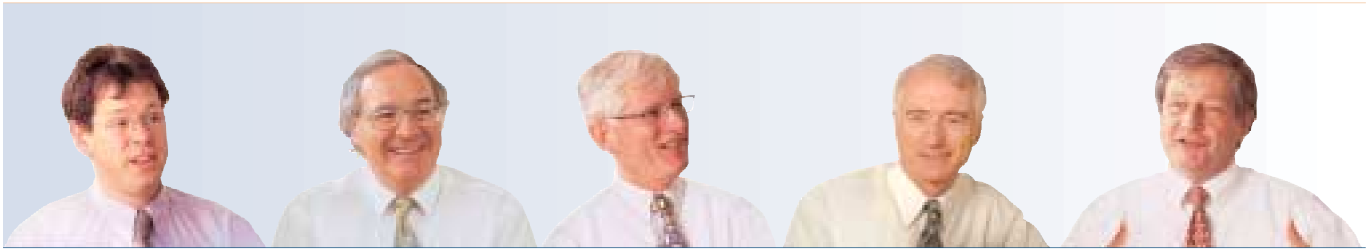
Tim Score age 43
Chief Financial Officer
Tim Score joined ARM as Chief Financial Officer and director in March 2002. Before joining ARM, he was Finance Director of Rebus Group Limited. He was previously Group Finance Director of William Baird plc, Group Controller at LucasVarity plc and Group Financial Controller at BTR plc.

Tudor Brown age 45
Chief Operating Officer
Tudor Brown was one of the founders of ARM. Before joining the Company, he was Principal Engineer at Acorn Computers, where he worked on the ARM R&D programme. At ARM, he was Engineering Director and Chief Technical Officer from 1993; in October 2000, he was appointed Executive Vice President, Global Development and in October 2001, he was appointed to the board as Chief Operating Officer.

Mike Inglis age 44
Executive Vice President, Marketing
Mike Inglis joined ARM as Executive Vice President, Marketing in June 2002, and was appointed to the board in August that year. Before joining ARM, he led the UK Communications and High Technology team at A.T. Kearney Management Consultants and held a number of senior operational and strategic marketing positions at Motorola. He previously worked in marketing, design and consultancy with Texas Instruments, Fairchild Camera and Instruments and BIS Macintosh. He gained his initial industrial experience with GEC Telecommunications. He is a non-executive director of Superscape Group plc.

Mike Muller age 45
Chief Technology Officer
Mike Muller was one of the founders of ARM. Before joining the Company, he was responsible for hardware strategy and the development of portable products at Acorn Computers. He was previously at Orbis Computers. At ARM he was Vice President, Marketing from 1992 to 1996 and Executive Vice President, Business Development until October 2000 when he was appointed Chief Technology Officer. In October 2001, he was appointed to the board.

Peter Cawdron age 60
Independent Non-Executive Director
Peter Cawdron joined the ARM board in March 1998. From 1983 to 1998 he worked for Grand Metropolitan plc, where he served as Group Strategy Development Director. He was previously Chief Financial Officer and a director of D'Arcy-MacManus & Masius Worldwide, Inc., and before that a member of the corporate finance team at S.G. Warburg & Co., Ltd. He qualified as a chartered accountant at Peat, Marwick, Mitchell & Co. in 1966. He is Chairman of Capital Radio plc and is a non-executive director of a number of UK listed companies, including Compass Group plc, The Capita Group plc, Christian Salvesen plc, Arla Foods UK plc and Johnstone Press plc.



Mike Muller Peter Cawdron Doug Dunn Lawrence Tesler John Scarisbrick

Doug Dunn age 59
Independent Non-Executive Director
Doug Dunn joined the ARM board in December 1998. He is President and Chief Executive Officer of ASM Lithography Holding N.V. Before joining ASML, he was Chairman and Chief Executive Officer of the Consumer Electronics Division of Royal Philips Electronics N.V. and a member of the board. He was previously Managing Director of the Plessey and GEC Semiconductor divisions and held several engineering and management positions at Motorola. He was awarded an OBE in 1992. He is a non-executive director of ST Microelectronics N.V. and Sendo Holdings plc.

Lawrence Tesler age 58
Independent Non-Executive Director
Lawrence Tesler was a member of the ARM board from its foundation until August 1997 and rejoined, as a non-executive director, in March 1998. He is Vice President, Engineering for Amazon.com Holdings Inc. Before joining Amazon he was Vice President and Chief Scientist for Apple Computer, Inc. He was previously on the staff of the Xerox Palo Alto Research Center, President of a software consulting firm and a research associate at Stanford University. He will be retiring from the board at the 2004 AGM, having served two three-year terms.

John Scarisbrick age 51
Independent Non-Executive Director
John Scarisbrick joined the ARM board in August 2001. He is a venture partner at Vortex Partners LLP in Dallas, Texas. He worked for Texas Instruments in the UK, France and the US for 25 years; he was most recently responsible for its $5 billion ASP business worldwide and had previously been President of Texas Instruments Europe (TI). Before joining TI, he worked in design roles at Rank Radio International and Marconi Space and Defence Systems. He is Chairman of Cambridge Positioning Systems Ltd; serves on the Technical Advisory Board of venture investor ViVentures; and is a director of Intrinsity, a fabless semiconductor company, and of SonIM, the leading developer of 2.5/3G voice instant messaging applications.

ARM Holdings plc
Secretary and registered office
Patricia Alsop
110 Fulbourn Road
Cambridge CB1 9NJ
United Kingdom

Registered number
2548782

Stockbrokers
Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA
United Kingdom

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

Legal advisers
UK law
Linklaters
One Silk Street
London EC2Y 8HQ
United Kingdom

US law
Davis Polk & Wardwell
99 Gresham Street
London EC2V 7NG
United Kingdom

Auditors
PricewaterhouseCoopers LLP
Abacus House
Castle Park
Cambridge CB3 0AN
United Kingdom

Registrars
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
United Kingdom
Tel: +44 (0)870 600 3984

Depositary
The Bank of New York
101 Barclays Street
New York
New York 10286
United States of America

Careful management of our cost base contributed to sequential improvements in profitability and good cash generation through the year

The cash-generative nature of ARM's business model enables us to address the significant opportunities for ongoing investment in future growth, research and development activities and strategic acquisitions.

Revenues

Total revenues for the year ended 31 December 2003 amounted to £128.1 million, a decrease of 15% from total revenues of £150.9 million in the year ended 31 December 2002. The actual average dollar exchange rate in 2003 was $1.64 (compared with the effective average exchange rate for ARM of $1.61) compared with $1.50 in 2002. This had the effect of reducing total reported revenues by approximately £9.6 million.

Licensing revenues in 2003 were £50.8 million, 40% of total revenues, compared with £83.0 million, or 55% of total revenues, in the year to 31 December 2002. Royalty revenues were £44.3 million, representing 34% of total revenues, in the year to 31 December 2003, compared with £26.8 million, or 18% of total revenues, in the year to 31 December 2002. Sales of development systems were £17.9 million, 14% of total revenues, in 2003 compared with £23.1 million, or 15% of total revenues, in 2002. Service revenues, which include consulting services and revenues from support, maintenance and training, were £15.1 million in 2003, representing 12% of total revenues compared with £18.0 million, or 12% of total revenues, in 2002.

Gross margin

Gross margin for the year to 31 December 2003 was 91%, the same as in 2002.

Operating expenses

Total operating expenses in 2003 were £98.6 million, compared with £96.6 million in 2002.

Research and development (R&D) expenses in 2003 were £48.1 million, 38% of revenues, compared with £48.7 million (excluding restructuring costs of £1.3 million), or 32% of revenues, in 2002. Sales and marketing costs decreased from £24.5 million (excluding restructuring costs of £0.3 million), or 16% of revenues in the 12 months to 31 December 2002, to £23.0 million or 18% of revenues in 2003. General and administration expenses were £27.5 million or 21% of revenues in the 12 months to 31 December 2003, compared with £21.5 million (excluding restructuring costs of £0.3 million), or 14% of revenues, in 2002. The 2003 expenses included £6.4 million in respect of the one-off cost of the settlement of the Herodion dispute. Excluding this one-off cost, general and administrative expenses in 2003 were £21.1 million or 16% of revenues.

Operating margin

Operating margin decreased to 14.4% in 2003, from 27.3% in 2002, as a result of reduced revenues and increased legal costs.

Interest receivable

Interest was £4.8 million for the year to 31 December 2003 compared with £4.4 million in 2002, reflecting the benefit of higher average cash balances in 2003.

Earnings and taxation

For the year ended 31 December 2003, profit before tax was £23.2 million, or 18.1% of revenues, compared with £45.5 million or 30.1% of revenues in the year ended 31 December 2002. The Group's taxation rate increased from 29% in the year to 31 December 2002 to 34% in 2003, mainly as a result of increased costs that are non-deductible for tax purposes. Fully diluted earnings for the year ended 31 December 2003 were 1.5 pence per share compared with 3.2 pence per share for the year ended 31 December 2002.

Balance sheet and cash flow

Net cash inflow from operating activities of £43.7 million was generated in the year; capital expenditure in the year was £3.6 million. Cash and short-term investments increased by £29.5 million to £159.8 million at 31 December 2003.

Trade debtors decreased to £17.3 million at 31 December 2003, from £20.5 million at 31 December 2002. The provision for doubtful debts decreased to £1.1 million at 31 December 2003, compared with £2.2 million at the end of 2002. Deferred revenues were £11.1 million at 31 December 2003, compared with £14.4 million at 31 December 2002.

Dividend

The board reviews uses of the Group's cash resources on an ongoing basis. In light of the Group's strong financial position and the cash generative nature of its business, the directors intend to introduce an annual dividend, with effect from the 2003 financial year. This will enable us to use our strong cash generation to return cash to shareholders while maintaining significant investment in R&D and satisfying the ongoing capital requirements of the business.

Recognising that ARM has significant opportunities to invest in the business, both organically and through "bolt-on" acquisitions, the directors recommend a combined interim and final dividend in respect of the year to 31 December 2003 of 0.6 pence per share which, subject to approval at the Annual General Meeting on 26 April 2004, will be paid on 7 May 2004 to shareholders on the register at 2 April 2004.

From 2004 onwards, the directors intend that an interim dividend will be paid in October of each year (commencing in October 2004) and a final dividend will be paid in May of each year (commencing in May 2005). The interim dividend is likely to represent 40% of the total dividend for the year. Under this policy, the interim dividend for 2003 would have been 0.25 pence and the final dividend 0.35 pence.

The board intends to adopt a progressive dividend policy which will take into account both the opportunity for continued investment in the business going forward and the underlying operational performance of the Group.

Tim Score Chief Financial Officer

Selected financial data/UK GAAP

	2003 £000	2002 £000*	2001 £000*	2000 £000*	1999 £000*
Turnover	**128,070**	150,922	146,274	100,730	62,120
Cost of sales	**(11,022)**	(13,185)	(17,289)	(11,647)	(9,803)
Gross profit	**117,048**	137,737	128,985	89,083	52,317
Total operating expenses	**(98,609)**	(96,608)	(83,203)	(57,927)	(35,794)
Group operating profit	**18,439**	41,129	45,782	31,156	16,523
Share of loss of associated undertaking	**–**	–	–	(85)	–
Total operating profit	**18,439**	41,129	45,782	31,071	16,523
Net gain on disposals of trade investments	**–**	–	314	–	–
Gain on part disposal of associated undertaking	**–**	–	–	512	–
Interest receivable, net	**4,801**	4,373	4,470	3,912	2,266
Profit on ordinary activities before taxation	**23,240**	45,502	50,566	35,495	18,789
Tax on profit on ordinary activities	**(7,977)**	(13,031)	(15,874)	(6,007)	(261)
Profit on ordinary activities after taxation	**15,263**	32,471	34,692	29,488	18,528
Equity minority interest	**(105)**	(232)	(303)	(192)	(64)
Profit attributable to shareholders	**15,158**	32,239	34,389	29,296	18,464
Dividends	**(6,106)**	–	–	–	–
Retained profit for the financial year	**9,052**	32,239	34,389	29,296	18,464
Capital expenditure	**3,605**	15,616	17,349	11,842	5,900
Research and development expenditure	**48,131**	48,674	38,920	27,518	16,966
Cash and short-term investments	**159,786**	130,304	104,467	75,266	51,804
Shareholders' funds	**180,435**	172,140	135,723	98,804	67,113
Employees at end of year (number)	**740**	721	722	619	443

* The prior years' figures have been restated solely as a result of the adoption of UITF 38, "Accounting for ESOP trusts" (see note 20).

Compliance with the Combined Code

The Group complies, and complied throughout 2003, with the 1998 Combined Code appended to the Listing Rules of the Financial Services Authority. The Group has reviewed the new Combined Code on Corporate Governance, published in July 2003, which applies to reporting years beginning on or after 1 November 2003 and sets out below the steps it has taken and intends to take in the light of this new guidance.

Composition and operation of the board

The board comprises five executive directors, four independent non-executive directors and the Chairman. The executive directors are the Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Technology Officer and Executive Vice President, Marketing. The four independent non-executive directors are independent in character and judgement and there are no relationships or circumstances which are likely to affect the judgement of any of them. They provide a blend of experience and considerable knowledge to the board's deliberations. Peter Cawdron, who is the Senior Independent Director and the financial expert, has extensive knowledge of UK public group issues and a strong financial background. Doug Dunn has experience of running large companies in the semiconductor and electronics industries. Lawrence Tesler and John Scarisbrick both have a broad understanding of the Group's technology and the practices of major US-based technology companies.

Lawrence Tesler will be retiring from the board at the Annual General Meeting (AGM) on 26 April 2004 having served two three-year terms as a non-executive director. It is intended that Jeremy Scudamore, who is CEO of Avecia Group (formerly the specialty chemicals business of Zeneca), be appointed as a non-executive director of the Company immediately following the AGM on 26 April 2004. He has considerable international business experience and will bring a broad range of skills to the board that extend beyond the semiconductor industry.

Peter Cawdron, who was last re-elected as a director at the 2003 AGM, will complete his second three-year term as a director of the Company in March 2004. The board is mindful of the principles set out in the new Combined Code. Following a review of the significant contribution Peter has made in his roles as Chairman of the audit committee and as the Senior Independent Director, and also to the general proceedings of the board, the board has decided that it is in the Company's best interests for Peter to be appointed for a third three-year term. The directors are subject to re-election every three years under Article 79 of the Articles of Association.

A resolution to change Article 70 of the Company's Articles of Association will be proposed at the AGM to increase the maximum number of directors from ten to twelve. This will enable further non-executive directors to be appointed, with the intention that they will comprise at least half the board (excluding the Chairman) in compliance with the new Combined Code. In addition, this will facilitate planning for orderly succession among the non-executive directors.

The board had six scheduled meetings during 2003 which were all attended by all the directors, with the exception of the April meeting when Mike Muller was absent and the November meeting when Tudor Brown was absent (in both cases for business reasons). There is a procedure in place for additional meetings on any pertinent issues to be organised as necessary during the year. In addition, the Chairman held two meetings with the non-executive directors without the executives present and the non-executive directors met on one occasion without the Chairman being present.

The board is responsible for setting the Company's strategic aims and ensuring that the necessary financial and human resources are in place for it to meet its objectives. The board has a formal schedule of matters specifically reserved for its decision, which includes the approval of major business matters, policies, operating and capital expenditure budgets, and ensuring high standards of corporate governance are maintained. 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 of a 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 day-to-day responsibility for managing the Group to the executive committee and has a number of committees, details of which are set out below.

The board is aware of the principle in the new Combined Code that it should undertake an annual evaluation of its own performance and that of its committees and individual directors, and intends to proceed with such an evaluation during 2004. In 2003, the executive committee (which includes the executive directors other than the Chairman) undertook a board effectiveness programme, which included collective and individual performance evaluation and was assisted by third-party facilitators.

During 2003 Mike Muller and Mike Inglis attended a three-day training course for PLC directors run jointly by Henley Management College and Ashridge and Manchester business schools. Further training for directors is planned for 2004.

Executive committee

The executive committee is responsible for implementing the strategy set by the board. Among other things, this committee is responsible for approval of standard licence agreements, ensuring that the Group's budget and forecasts are properly prepared, that 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 (excluding the Chairman) and the directors of ARM Limited, and meetings are attended by the Company Secretary and other senior operational personnel, as appropriate.

Audit committee

The audit committee has written terms of reference which were updated during the year to reflect the requirements of the new Combined Code. The committee has responsibility for, among other things, monitoring the integrity of the financial statements of the Company and any formal announcements relating to the Company's financial performance, and for reviewing any significant financial reporting judgements contained in them; reviewing the Company's internal controls and risk management systems;

making recommendations to the board in relation to the appointment, remuneration and resignation or dismissal of the Group's external auditors; reviewing and monitoring the external auditors' independence and objectivity and the effectiveness of the audit process; developing and implementing policy on the engagement of the external auditors to supply non-audit services; and considering compliance with legal requirements, accounting standards, the Listing Rules of the Financial Services Authority and the requirements of the Securities and Exchange Commission.

The committee also keeps under review the 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". To avoid the possibility of the auditors' objectivity and independence being compromised, the Group's tax consulting work is carried out by the auditors only 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. From time to time, however, the Group will engage the auditors to perform advisory work on matters relating to human resources and royalty audits. The Group may also seek professional advice from another firm of independent consultants or its legal advisers.

The current audit committee comprises Peter Cawdron (Chairman), Doug Dunn and John Scarisbrick. Peter Cawdron is the financial expert as defined in the Sarbanes Oxley Act. The committee met three times during 2003, once before the release of the preliminary announcement of the 2002 results to review the results and audit findings, once to review the half-year interim results and once before the year end to discuss the approach to the audit of the 2003 results. All committee members attended all three meetings.

The external auditors, Chief Executive Officer, Chief Financial Officer and the Company Secretary attend all meetings in order to ensure that all the information required by the audit committee for it to operate effectively is available. 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 24.

Nomination committee

The nomination committee leads the process for board appointments and makes recommendations to the board in relation to any new appointments of executive and non-executive directors, and 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 met once during 2003. The committee has written terms of reference which were updated during 2003 to reflect the requirements of the new Combined Code. In relation to the appointment of Jeremy Scudamore, the services of an external search consultancy were used.

Internal control/risk management

The board of directors has overall responsibility for ensuring that the Group maintains an adequate system of internal control and risk management and for reviewing its effectiveness. The board has reviewed the system of internal control including internal financial controls. Such systems are designed to manage rather than eliminate the risks inherent in a fast-moving, high-technology business and can, therefore, provide only 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 the board and the executive committee as well as managers representing the different business units and functions across the Group. During 2003 the risk review process was enhanced by the constitution of a risk review committee consisting of the Chief Technology Officer, the Chief Financial Officer, the Financial Controller and the Company Secretary. The team is responsible for identifying and evaluating risks which may impact on the Group's strategic and business objectives, and for monitoring the progress of actions designed to mitigate such risks. The risk review team receives and reviews quarterly reports from business unit managers and corporate functions and its findings are considered and challenged by the risk review committee. The team reports to the executive committee once a year and, in turn, the risk review committee reports to the board once a year.

In July 2003 a disclosure committee was set up in compliance with the Sarbanes-Oxley Act 2002. The committee, which comprises the Chief Executive Officer, the Chief Financial Officer, the Financial Controller, the General Counsel and the Company Secretary, is responsible for ensuring that disclosures made by the Company to its shareholders and the investment community are accurate, complete and fairly present the Company's financial condition in all material respects.

In addition, there is a series of interconnected meetings that span the Group from the weekly management meeting chaired by the Chief Executive Officer and the weekly business review meeting chaired by the Vice President, Operations, 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, to the board meetings of the Group. 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 within 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 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.

As required by the Turnbull guidance, the board has considered whether it would be appropriate for the Company to have its own financial internal audit function and has concluded that, taking account of its relatively small size, and a high degree of centralisation in the way the business is run, this is not appropriate at present. It does, however, have an operational internal audit function that audits the Group's business and product/project management processes. These processes are documented, maintained and continuously improved, for effectiveness and efficiency. In addition, they 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 corporate social responsibility report is on page 21 of this report and also on the Group's website www.arm.com. The Group joined the Institute of Business Ethics in 2000 and, following a process of independent verification, it received confirmation of its admittance to the GoodCorporation network in August 2001. This qualification provides assurance that it 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. This independent verification process is repeated each year and, during 2003, the Group successfully retained its membership.

As a company whose primary business is the licensing of intellectual property (IP), 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. In 2003 ARM was named Employer of the Year in the UK National Business Awards. 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. Staff make use of computer-aided design tools to generate intellectual property. This involves neither hazardous substances nor complex waste emissions. With the exception of Development Systems products, the majority of "products" sold by the Group comprise microprocessor core designs that are delivered electronically to customers.

The Group does, however, recognise the increasing importance of environmental issues and these are discussed at board level where the Chief Financial Officer takes responsibility for them. A number of initiatives in this area have continued in 2003. The Group's environmental policy is published on its website. An environmental action plan is implemented through various initiatives. These include monitoring resource consumption and waste creation so that targets set for improvement are realistic and meaningful, ensuring existing controls continue to operate satisfactorily and working with suppliers to improve environmental management along the supply chain.

The Group has continued to compile data on energy use, including estimates for international business travel and an analysis of employee transport to and from work. Energy usage and resource consumption data for 2002 and 2003 are published in the Group's corporate social responsibility report on its website. The provision of cycle sheds, showers and changing facilities at its 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 its electronic document management systems might reduce the need for paper documents. The Group can also demonstrate an increase in paper and packaging recycling and an improvement in the facilities in place to promote recycling of more materials. Energy usage is monitored closely to understand how it is used, which aids the setting of new targets. Renewable energy sources are also being investigated.

Health and safety

Although ARM operates in an industry and in environments which are considered low risk from a health and safety perspective, the safety of employees, contractors and visitors is a priority in all ARM workplaces worldwide. Continual improvement in safety management systems is achieved through detailed risk assessments to identify and eliminate potential hazards and occupational health assessments for employees. The UK offices are covered by a health and safety committee, fire wardens and first aiders. Each year the GoodCorporation verification ensures that the criteria in its charter are met. The UK offices are also audited by the British Safety Council and the Company achieved three stars in the 2003 audit. Other offices have similar cover dependent on local needs, practices and customs.

Relationships with shareholders

The board makes considerable efforts to establish and maintain good 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 its website.

The board actively encourages participation at the Annual General Meeting, scheduled for 26 April 2004, 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

Patricia Alsop Company Secretary

Corporate social responsibility

ARM considers itself to be a good corporate citizen. While we know that there will always be more to do, we strive to reduce the impact we make on the environment and to increase our connections with the communities in which we operate. We also work hard to connect with our shareholders, partners, suppliers and employees.

We are corporate members of the Institute of Business Ethics (IBE) and were one of the first members of GoodCorporation, which was founded in 2001 to help organisations to develop, manage and monitor their corporate responsibilities. Based on principles set out by the IBE, the GoodCorporation charter enables companies to measure how effective they are in achieving these responsibilities. Our commitment to the charter includes being verified against it each year.

In addition, we are listed on the FTSE4Good Index and take part in the Business in the Environment Index and the Corporate Responsibility Index.

The environment

Our business focuses on designing IP which enables devices to use less power and, as a result, to be more environmentally friendly. Our activities do not produce harmful waste or emissions and the Ethical Investment Research Service (EIRIS) grades us as an environmentally "low impact" business. Nevertheless, we monitor our environmental performance to enable us to set targets for reducing paper usage (and increasing the amount we recycle), and controlling water consumption. There are recycling bins for aluminium cans in the majority of our offices and our air conditioning systems run on less environmentally damaging refrigerants.

We discourage the supply of company cars: in a company of 740 people, there are only 20. We encourage our people to cycle to work or to share car journeys, and we measure business travel.

Connecting with local communities

Our aim is to be a good corporate citizen of the communities in which we operate. As such, we support local initiatives and fundraising. In the UK, we tend to focus on educational projects – particularly for pupils who are interested in mathematics, science, IT and business subjects. This support is sometimes financial, sometimes in the form of our employees' time and skills.

Supporting education. Our support for education stretches from funding an information technology centre at a local junior school, to working on specific projects with students at the Judge Institute, Cambridge University's business school. We have helped three schools near our Cambridge, UK offices and one near our Maidenhead, UK offices to achieve specialist school status; we support mathematics lectures for gifted school students at the Royal Institution and contribute to the funding to train the UK team for the International Maths Olympics. In addition, we have relationships with a number of universities. Our Chairman, for example, is a visiting professor at Liverpool and we worked with Loughborough to design a degree course which is based on the ARM architecture, with the result that we now have a number of Loughborough graduates working with us.

Supporting good causes. We encourage our people to support their local communities. Some are school governors, some help children improve their reading skills, others support charities. Our employees at our Austin, Texas office have, for example, helped with Special Olympics Texas and worked on a new home for an underprivileged family, and employees at Austin and at Los Gatos have given their time to charities for the homeless.

We "double the efforts" of employees who raise money for approved charities by matching the funds they raise (with the exception of political donations or other causes that might damage ARM's good reputation). Charities for cancer, children, cystic fibrosis and MS have been some of the beneficiaries of this scheme.

Connecting with our investors

We take care to provide accurate and timely information for our investors – large and small. Board members and other senior managers communicate regularly with our institutional shareholders. Our retail investors are sent the annual report and a six-monthly report each year. In addition, our website www.arm.com carries comprehensive information about our business, partners and products, including all press releases.

Connecting with employees

Our aim is to attract and retain the best people available by being a good and ethical employer. The skills, knowledge and motivation of our people are crucial to ARM's success. We promote and support individuals and teams through on-the-job and formal training, coaching and mentoring. Our staff turnover is approximately 5% a year.

Our Employee Assistance Programme helps staff and their families with issues such as care for children or elderly relatives, legal and health advice, and stress or other counselling. We were named Employer of the Year in both the Midlands and East of England regions, and in the UK National Business Awards 2003.

Equal opportunities. We need highly-qualified staff and do not see age, colour, disability, ethnic origin, gender, political or other opinion, religion or sexual orientation as a barrier to employment. If any member of staff becomes disabled, we assess their needs and abilities with a view to their continuing in their current role. If this is impossible, we seek to offer them alternative employment.

Benefits. Employees receive private healthcare; permanent health, travel and life insurance; pensions; sabbaticals; flexible working; stock options; and a save-as-you-earn share scheme. We encourage understanding and acceptance of national and cultural diversity by giving employees the opportunity to work in our offices other than in their home country.

Accessibility

We endeavour to provide access to all whether it be through building design to allow easy disabled access or through improving access to our website for those with visual impairments.

Health and safety

The safety of employees, contractors and visitors is a priority. We measure and analyse all accidents and "near misses" (we have had only one RIDDOR reportable accident in the Company's history); by monitoring patterns or trends we can identify potential problems and work to avoid them. We are verified by GoodCorporation each year to ensure that we meet its health and safety requirements and our UK offices are also audited by the British Safety Council. In the UK, we have a health and safety committee and each office has fire wardens and first aiders. Our overseas offices have the health and safety cover required by local legislation. Health and safety is high on our agenda: we publicise work-related matters, advise employees to be prepared for winter driving and to take precautions to prevent hay fever or flu.

Directors' report/UK GAAP

The directors present their annual report and audited financial statements for the year ended 31 December 2003.

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, Maidenhead, Sheffield, and Blackburn, UK; Sophia Antipolis, France; Leuven, Belgium; and Austin, Texas in the US. More information about the 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. The Group intends to enter into licence agreements with new customers and to increase the range of new technology supplied to existing customers. Relationships will continue to be established with third-party tools and software vendors to ensure that their products will operate with the ARM architecture. As a result of its position as an emerging standard in its industry, the Group is presented with many opportunities to acquire complementary technology or resources. It continues to review these opportunities and in July 2003 the Group acquired Adelante Technologies N.V. which is developing configurable data engine technology, OptimoDE.

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

The directors recommend a combined interim and final dividend in respect of the year to 31 December 2003 of 0.6 pence per share (total cost £6,106,000) which, subject to approval at the Annual General Meeting on 26 April 2004, will be paid on 7 May 2004 to shareholders on the register at 2 April 2004.

Research and development (R&D)

R&D is of major importance and, as part of its research activities, the Group collaborates closely with universities worldwide. Key areas of product development for 2004 include the development of further power saving technologies (OptimoDE and central processing unit (CPU) cores based on symmetric multiprocessor technology), improved security through the TrustZone and SecurJC technologies and developments in superscalar CPU architectures.

The Group incurred R&D costs of £48.1 million in 2003, compared with £48.7 million in 2002, which have been charged to the profit and loss account.

Donations

During the year the Group made donations for charitable purposes of £42,486 (2002: £27,939). The total amounts given for each such purpose were:

Local Cambridge charities	£9,411
Promotion of education	£6,687
Wider understanding of science, maths and information technology	£12,500
Medical research	£7,439
Relief of poverty	£6,449

The Group does not make any political donations. ARM employees are encouraged to offer their time and expertise to help charities and other groups in need. The Group operates a gift matching system for employee fundraising.

Impact of International Financial Reporting Standards (IFRS)

During the year, the Group has considered the impact that implementing IFRS in 2005 will have on its financial statements and reporting functions. The project is ongoing, and the Group continually monitors the new announcements being made by the IASB in furthering its plans for implementation. To date, the key areas that the Group has reviewed and which may affect the financial statements are derivatives and financial instruments, revenue recognition, intangibles, share-based payments, acquisition accounting and accounting for R&D costs. Further areas are currently being assessed, and the Group is confident that it is well positioned for the transition.

Directors in the year

The following served as directors of the Company during the year ended 31 December 2003:

Sir Robin Saxby KBE (Chairman)
Warren East (Chief Executive Officer)
Tim Score (Chief Financial Officer)
Tudor Brown (Chief Operating Officer)
Mike Muller (Chief Technology Officer)
Mike Inglis (Executive Vice President, Marketing)
Peter Cawdron (independent non-executive, Senior Independent Director, financial expert)
Doug Dunn OBE (independent non-executive)
John Scarisbrick (independent non-executive)
Lawrence Tesler (independent non-executive)

Election of directors

In accordance with the Group's Articles of Association, Warren East will retire by rotation at the Company's Annual General Meeting (AGM) and will seek re-election at that meeting. (See page 14 for his biography.) Lawrence Tesler has completed two three-year terms as a non-executive director and will retire from the board at the AGM on 26 April 2004. It is intended that Jeremy Scudamore will be appointed as an additional non-executive director immediately following the AGM on 26 April 2004. Further details are included in the corporate governance report on page 18.

Directors' shareholdings in the Company

The interests of the directors in the Company's ordinary shares of 0.05 pence, all of which were beneficially held, are disclosed in the remuneration report on page 26.

Substantial shareholdings

The directors are aware of the following substantial interests in the issued share capital of the Company as at 17 February 2004:

	Percentage of issued ordinary share capital
Capital Group Companies	10.1%
Fidelity Investments	6.9%
Legal and General Investment Management	4.5%
Threadneedle Asset Management	4.3%
Janus Capital Corporation	3.8%
Aviva plc	3.0%

Save for the above, the Company has not been notified, as at 17 February 2004, of any material interest of 3% or more or any non-material interest exceeding 10% of the issued share capital of the Company.

Disabled persons

The Group has a strong demand for highly qualified staff and, as such, disability is not seen to be an inhibitor to employment or career development. 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 its decision-making processes. To this end, internal conferences and communications meetings are held regularly which involve employees from all parts of the Group in discussions on future strategy and developments. Furthermore, employee share ownership is encouraged and all staff are able to participate in one of the 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 trade unions.

Policy on payment of creditors

The Group's policy is to pay suppliers before the end of the month following 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. Trade creditors of the Group at 31 December 2003 were equivalent to 23 days' purchases for the Group (2002: 19 days') and nil days for the Company in both years.

Annual General Meeting (AGM)

The AGM will be held at the Group's offices in Cambridge, UK, on 26 April 2004 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 AGM. 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.

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Group will be proposed at the AGM.

Notice of the AGM is set out in the circular to shareholders accompanying this annual report.

By order of the board

Patricia Alsop 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 grants 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 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 Financial Services Authority.

The committee is chaired by Doug Dunn, and Peter Cawdron, John Scarisbrick and Lawrence Tesler are members. The committee met three times during 2003 and all meetings were attended by all the committee members, with the exception of the December 2003 meeting when Lawrence Tesler was unable to attend. 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 external advisers, generally appointed by the Executive Vice President, Human Resources, in the furtherance of its duties and makes use of this. During 2003, Linklaters, Watson Wyatt, Deloitte & Touche and the Executive Vice President, Human Resources, have provided advice or services to the committee. Linklaters provided other legal services and Watson Wyatt provided pension advice to the Company during this period. The Chairman, Chief Executive Officer and Executive Vice President, Human Resources, normally attend for part of the remuneration committee meetings. No director is involved in deciding his 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 principles set out in the Combined 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 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 three elements: annual cash bonus, discretionary share options and conditional awards under the Long Term Incentive Plan. All 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, in 2003 a shareholding guideline was introduced under which executive directors and certain senior managers are required to build up a holding of shares in the Company over a period of five years. The shareholdings will be built up of shares received under the Company's discretionary share option schemes and/or the Long Term Incentive Plan and, in the case of executive directors, the required holding is 100% of basic salary.

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 executive directors' remuneration with a bonus of up to 50% of basic pay being available through the executive bonus plan if all targets are met. Payment of bonus is subject to the achievement of targets set by the remuneration committee which are directly related to the Group's financial results. No bonuses are payable to executive directors in respect of 2003.

For the 2004 operation of the bonus plan, three targets have been set by the remuneration committee, namely growth in profit before tax and growth in revenues (each of which account for 50% of total bonus potential) with the proviso that no bonus will be payable unless earnings per share exceed a defined target. If the Group's targets are achieved, bonuses will be payable on a linear basis between the minimum and the maximum of the agreed range. Annual bonuses can be doubled under the deferred bonus plan if payment is deferred for three years. Details of the deferred bonus plan are set out on page 29.

The Group operates a number of share option plans and employees generally receive a number of share options according to their grade, past performance and length of service. 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 generally 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 conditions are satisfied.

For options granted before January 2003, the performance condition is that the Group must achieve average real EPS growth of at least 33.1% (i.e. 33.1% greater than the percentage increase (if any) in the Retail Prices Index) over a performance period of three years from the start of the financial year in which the options were granted (the "performance period").

For options granted from January 2003 under the performance condition, 50% of the shares under option will vest after three years if the Group achieves average real EPS growth of 9.3% over the performance period. If 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.

For options granted from January 2004 under the performance condition, 50% of the shares under option will vest after three years if the Group achieves average real EPS growth of 12.5% over the performance period. If 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 12.5% and 33.1%, the number of shares which vest after three years increases on a straight-line basis.

Pensions

The Group does not operate its own pension scheme but makes payments into a Group personal pension plan, which is a money purchase scheme. 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 may be terminated by either party on one year's notice. The service contracts also terminate when executive directors reach age 65. With the exception of the Chairman, 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 an executive 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
Mike Muller	31 January 1996
Mike Inglis	17 July 2002

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.

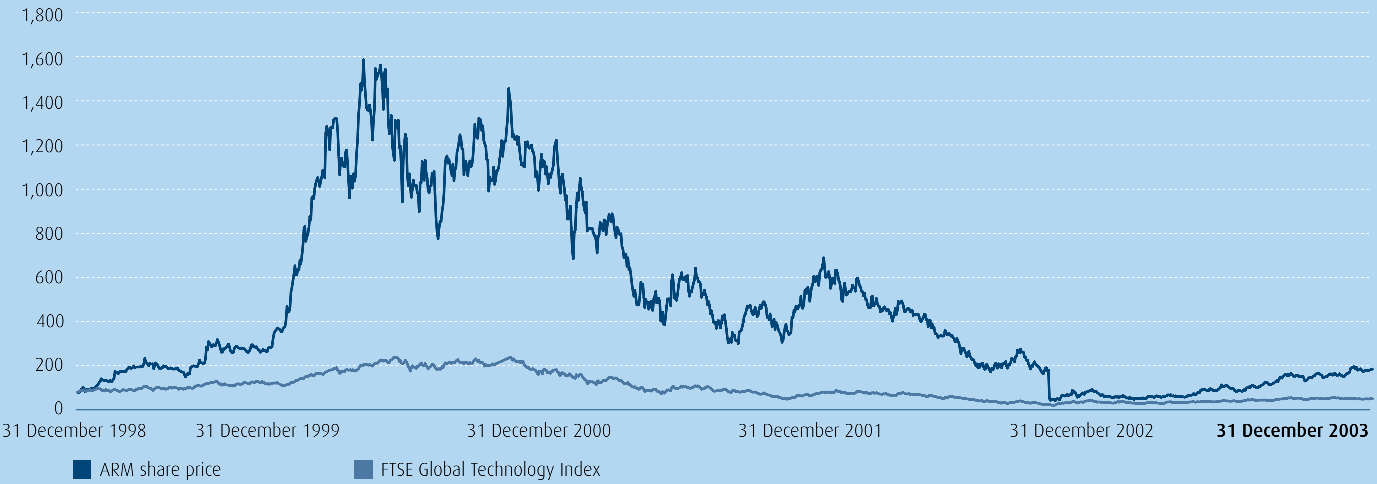
Non-executive directors

During 2003, 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. Peter Cawdron, an independent non-executive director who currently holds more than five directorships, has devoted during his term of office, and continues to be 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 and their term of appointment is three years. Non-executive directors do not have service contracts, 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 Company's total shareholder return (TSR) together with the TSR for the FTSE Global Technology Index of 50 companies from 31 December 1998 is shown below. The TSR has been calculated in accordance with the Directors' Remuneration Report Regulations 2002. The TSR for the Company's shares was 101% over this period compared with -29% 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 use ARM technology in their end products.

Directors' shareholdings in the Company

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

Director	31 December 2003 Number	31 December 2002 Number
Sir Robin Saxby	22,363,060	25,632,860
Warren East	174,920	174,920
Tim Score	10,000	10,000
Tudor Brown	1,496,460	1,496,460
Mike Muller	1,891,860	1,891,860
Mike Inglis	10,000	10,000
Doug Dunn	48,000	48,000
Peter Cawdron	98,000	98,000
John Scarisbrick	10,800	10,800
Lawrence Tesler	111,000	111,000

In addition to the interests disclosed above, all the executive directors (together with all the employees of the Group) are potential beneficiaries of both the ARM Holdings plc Employee Share Ownership Plan 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 721,080 ordinary shares respectively at 31 December 2003, and 5,000,000 and 1,796,754 shares respectively at 31 December 2002. Sir Robin Saxby sold 1,000,000 shares in the Company on 3 February 2004 taking his interest to 21,363,060 at the date of this report. There have been no other changes in directors' interests in the Company's shares to the date of approval of the remuneration report.

Auditable information

The following information has been audited by the Company's auditors, PricewaterhouseCoopers LLP, as required by Schedule 7A to the Companies Act 1985.

Interests in share options

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

Director	As at 1 January 2003 Number	Granted Number	Exercised Number	**As at 31 December 2003 Number**	Exercise price £	Earliest date of exercise	Expiry date
Sir Robin 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	–	(600,000)	**165,000**			
Warren 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	22/05/08***
	100,000	–	–	**100,000**	2.465	19/04/05	19/04/09***
	–	914,285	–	**914,285**	0.4375	30/01/06	30/01/10***
	327,058	914,285	–	**1,241,343**			
Tim Score	206,896	–	–	**206,896**	2.465	19/04/05	19/04/09***
	–	777,142	–	**777,142**	0.4375	30/01/06	30/01/10***
	206,896	777,142	–	**984,038**			
Tudor 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	19/04/09***
	–	731,428	–	**731,428**	0.4375	30/01/06	30/01/10***
	240,000	731,428	–	**971,428**			
Mike 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	19/04/09***
	–	731,428	–	**731,428**	0.4375	30/01/06	30/01/10***
	236,351	731,428	–	**967,779**			
Mike Inglis	223,515	–	–	**223,515**	2.1475	27/05/03	26/05/09†
	–	731,428	–	**731,428**	0.4375	30/01/06	30/01/10***
	223,515	731,428	–	**954,943**			

* 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.

No options lapsed in the year.

On 22 April 2003 Sir Robin Saxby exercised an option over 600,000 shares and made a donation of such shares to the University of Liverpool. The gain calculated at the exercise date was £330,000 (2002: £nil). The share price on the date of exercise was £0.57.

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 (RPI) over a period of three years 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 2004, discretionary share options were granted to the following executive directors: Warren East 400,000; Tim Score 320,000; Tudor Brown 320,000; Mike Muller 288,000; and Mike Inglis 288,000. The exercise price is 125 pence and all are subject to performance conditions.

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 12.5% greater than the percentage increase (if any) in the RPI over a performance period of three years 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 RPI over the performance period, 100% of the shares under option will vest after three years from grant. Where the average EPS growth is between 12.5% and 33.1% greater than the percentage increase (if any) in the RPI 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 2003 Number	Granted Number	Lapsed Number	**As at 31 December 2003 Number**	Exercise price £	Earliest date of exercise	Expiry date
Sir Robin Saxby	3,157	–	(3,157)	**–**	3.0685	01/07/04	31/12/04
	–	15,771	–	**15,771**	0.5865	01/08/06	31/12/06
	3,157	15,771	(3,157)	**15,771**			
Warren East	3,157	–	(3,157)	**–**	3.0685	01/07/04	31/12/04
	–	15,771	–	**15,771**	0.5865	01/08/06	31/12/06
	3,157	15,771	(3,157)	**15,771**			
Tim Score	–	27,152	–	**27,152**	0.5865	01/08/08	31/12/08
Tudor Brown	3,157	–	–	**3,157**	3.0685	01/07/04	31/12/04
Mike Inglis	3,626	–	(3,626)	**–**	1.8254	01/07/07	31/12/07
	–	15,771	–	**15,771**	0.5865	01/08/06	31/12/06
	3,626	15,771	(3,626)	**15,771**			

Long Term Incentive Plan

A Long Term Incentive Plan was approved by shareholders at the 2003 Annual General Meeting. Conditional share awards were made on 25 July 2003 to directors, as follows:

Director	As at 1 January 2003 Number	Conditional award Number	**As at 31 December 2003 Number**	Vesting date
Warren East	–	248,447	**248,447**	January 2006
Tim Score	–	211,180	**211,180**	January 2006
Tudor Brown	–	198,758	**198,758**	January 2006
Mike Muller	–	198,758	**198,758**	January 2006
Mike Inglis	–	198,758	**198,758**	January 2006

Conditional awards will vest to the extent that the performance criteria are satisfied over a three-year performance period from 1 January 2003 to 31 December 2005. The performance conditions are based on the Company's TSR when measured against that of two comparator groups (each testing half of the shares comprised in the award). The first index comprises UK companies across all sectors (FTSE 250) and the second comprises predominantly US companies within the Hi Tech sector (FTSE Global Technology Index). For each comparator group, the number of shares that may vest may be up to a maximum of 200% of the shares if the Company's TSR ranks in the upper decile, 50% will vest in the event of median performance and between median and upper decile performance vesting will increase on a straight-line basis. No shares will be received for below-median performance. In addition, no shares will vest unless the committee is satisfied that there has been a sustained improvement in the underlying financial performance of the Company.

Except as described above, there have been no changes in directors' interests under the Group's share option schemes since the end of the 2003 financial year up to the date of approval of the remuneration report.

The Company'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 Company as at 31 December 2003 was 128.5 pence. The closing mid-price ranged from 43.75 pence to 136.0 pence during the year.

Deferred bonus plan

The deferred bonus plan was introduced in 2001 and enables directors to double their annual bonus if payment is deferred for three years, and to receive 6% interest per annum on the deferred element. Warren East elected to participate in the plan 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 interest. There are no other outstanding arrangements under this plan.

Directors' emoluments

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

Director	Fees £	Basic salary £	Benefits** £	Bonus payments £	Subtotal £	Pension contributions £	**Total 2003 £**	Total 2002 £
Executive								
Sir Robin Saxby	–	200,000	11,710	–	211,710	24,638	**236,348**	235,747
Warren East	–	200,000	11,710	–	211,710	9,855	**221,565**	201,281
Tim Score*	–	170,000	10,728	–	180,728	9,855	**190,583**	159,559
Tudor Brown	–	160,000	11,710	–	171,710	9,855	**181,565**	166,281
Mike Muller	–	160,000	11,710	–	171,710	9,855	**181,565**	166,281
Mike Inglis*	–	160,000	11,710	–	171,710	9,855	**181,565**	68,733
Jonathan Brooks*	–	–	–	–	–	–	**–**	38,779
Pete Magowan*	–	–	–	–	–	–	**–**	100,548
Total	–	1,050,000	69,278	–	1,119,278	73,913	**1,193,191**	1,137,209
Non-executive								
Peter Cawdron	24,000	–	–	–	24,000	–	**24,000**	24,000
Doug Dunn	24,000	–	–	–	24,000	–	**24,000**	24,000
John Scarisbrick	24,000	–	–	–	24,000	–	**24,000**	24,000
Lawrence Tesler	24,000	–	–	–	24,000	–	**24,000**	24,000
Total	96,000	–	–	–	96,000	–	**96,000**	96,000
Total	96,000	1,050,000	69,278	–	1,215,278	73,913	**1,289,191**	1,233,209

* For T Score and M Inglis, the comparative salaries shown are from their date of appointment in 2002. For J Brooks and P Magowan, the comparative figures show the salary up to the date of their resignations from the board in 2002.

** 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.

Mike Inglis was appointed as a non-executive director of Superscape Group plc on 16 July 2003. The Group holds 12% of the issued share capital of Superscape Group plc and more details about this investment are included in note 13 on page 43. In this capacity, Mike Inglis received remuneration totalling £7,000 up to 31 December 2003 and was awarded options over 20,000 shares in Superscape Group plc at an option price of 33 pence on 7 January 2004. The shares will vest in thirds over the next three years providing that performance targets are met.

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 year that 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 that period. In preparing those 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 and Company will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and Company 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 Company 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, contained in the directors' remuneration report ("the auditable part").

Respective responsibilities of directors and auditors

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

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 Company'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, ARM: connected, directors and advisers, financial review, corporate governance, corporate social responsibility, 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 issued in June 1998 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 2003 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
10 March 2004

Consolidated profit and loss account/UK GAAP

For the year ended 31 December 2003

	Notes	2003 £000	2002 £000	2002 £000
Turnover				
– continuing operations		**127,207**		150,922
– acquisitions	2	**863**		–
	2	**128,070**		150,922
Cost of sales	3	**(11,022)**		(13,185)
Gross profit	3	**117,048**		137,737
Operating expenses				
Research and development	3	**(48,131)**	(48,674)	
Exceptional research and development	6		(1,327)	
				(50,001)
Sales and marketing	3	**(23,007)**	(24,516)	
Exceptional sales and marketing	6		(320)	
				(24,836)
Administrative expenses	3	**(27,471)**	(21,458)	
Exceptional administrative expenses	6		(313)	
				(21,771)
Total operating expenses		**(98,609)**		(96,608)
Operating profit				
– continuing operations		**18,215**		41,129
– acquisitions		**224**		–
Group operating profit	2	**18,439**		41,129
Interest receivable and similar income		**4,801**		4,373
Profit on ordinary activities before taxation	2, 6	**23,240**		45,502
Tax on profit on ordinary activities	7	**(7,977)**		(13,031)
Profit on ordinary activities after taxation		**15,263**		32,471
Equity minority interest	23	**(105)**		(232)
Profit for the financial year	8	**15,158**		32,239
Dividends proposed	9	**(6,106)**		–
Retained profit for the financial year	20	**9,052**		32,239
Earnings per 0.05 pence ordinary share				
Basic	10	**1.5p**		3.2p
Diluted	10	**1.5p**		3.2p

Statement of Group total recognised gains and losses/UK GAAP

	Notes	2003 £000	2002 £000
Profit for the financial year		**15,158**	32,239
Foreign exchange difference on consolidation	20, 21	**(1,425)**	(807)
Total recognised gains for the year and since last annual report		**13,733**	31,432

Consolidated balance sheet/UK GAAP
As at 31 December 2003

	Notes	2003 £000	2002 £000*
Fixed assets			
Intangible assets	11	**7,547**	9,153
Tangible assets	12	**16,583**	25,721
Investments	13	**4,759**	4,229
		28,889	39,103
Current assets			
Stocks	14	**931**	1,515
Debtors	15	**29,829**	33,558
Short-term investments	17	**129,663**	126,013
Cash at bank and in hand	17	**30,123**	4,291
		190,546	165,377
Creditors: amounts falling due within one year	16	**(38,937)**	(31,483)
Net current assets		**151,609**	133,894
Total assets less current liabilities		**180,498**	172,997
Provisions for liabilities and charges	18	**(63)**	(16)
Net assets	2	**180,435**	172,981
Capital and reserves			
Called-up share capital	19	**512**	511
Share premium account	20	**81,137**	80,883
Other reserves	20	**(2,088)**	(663)
Profit and loss account	20	**100,874**	91,409
Equity shareholders' funds	21	**180,435**	172,140
Minority interest – equity	23	**–**	841
Capital employed		**180,435**	172,981

* The prior year's figures have been restated solely as a result of the adoption of UITF 38, "Accounting for ESOP trusts" (see note 20).

The financial statements on pages 32 to 55 were approved by the board of directors on 10 March 2004 and were signed on its behalf by:

Sir Robin Saxby Director

Company balance sheet/UK GAAP
As at 31 December 2003

	Notes	2003 £000	2002* £000
Fixed assets			
Investments	13	**–**	–
Current assets			
Debtors	15	**44,637**	35,340
Short-term investments		**50,223**	48,381
Cash at bank and in hand		**50**	50
		94,910	83,771
Creditors: amounts falling due within one year	16	**(6,400)**	(219)
Net current assets		**88,510**	83,552
Total assets less current liabilities		**88,510**	83,552
Net assets		**88,510**	83,552
Capital and reserves			
Called-up share capital	19	**512**	511
Share premium account	20	**81,137**	80,883
Profit and loss account	20	**6,861**	2,158
Equity shareholders' funds		**88,510**	83,552

* The prior year's figures have been restated solely as a result of the adoption of UITF 38, "Accounting for ESOP trusts" (see note 20).

The financial statements on pages 32 to 55 were approved by the board of directors on 10 March 2004 and were signed on its behalf by:

Robin Saxby

Sir Robin Saxby Director

Consolidated cash flow statement/UK GAAP

For the year ended 31 December 2003

	Notes	2003 £000	2002 £000
Net cash inflow from operating activities	24	**43,740**	52,087
Returns on investments and servicing of finance			
Interest received		**4,930**	4,187
Net cash inflow from returns on investments and servicing of finance		**4,930**	4,187
Taxation			
Withholding tax paid		**(2,940)**	(5,011)
UK corporation tax paid		**(6,161)**	(10,592)
Overseas tax paid		**(824)**	(1,155)
Tax paid		**(9,925)**	(16,758)
Capital expenditure and financial investment			
Purchase of fixed asset investments	13	**(1,152)**	(1,500)
Purchase of tangible fixed assets		**(3,311)**	(15,616)
Sale of tangible fixed assets		**34**	35
Purchase of intangible fixed assets	11	**(655)**	(855)
Proceeds received by QUEST on allocation of own shares held		**263**	222
Net cash outflow for capital expenditure and financial investment		**(4,821)**	(17,714)
Acquisitions			
Purchase of subsidiary undertakings		**(3,413)**	–
Net cash acquired with subsidiary undertaking		**23**	–
Net cash outflow for acquisitions	27	**(3,390)**	–
Net cash inflow before management of liquid resources and financing		**30,534**	21,802
Management of liquid resources			
(Increase) in short-term investments	26	**(3,650)**	(31,637)
Financing			
Issue of shares	19	**255**	4,763
Net cash inflow from financing		**255**	4,763
Increase/(decrease) in cash	26	**27,139**	(5,072)

Details of the Group's net funds are shown in note 26.

1 Principal accounting policies

The financial statements have been prepared in accordance with the Companies Act 1985 and 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.

Changes in accounting policies The Group has adopted Urgent Issues Task Force (UITF) 38, "Accounting for ESOP Trusts", 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 20 and the share schemes accounting policy below).

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 2003. Intra-Group transactions and profits are eliminated fully on consolidation. The results of subsidiaries acquired in the year are included in the consolidated profit and loss account from the date they are acquired. On acquisition, all of the subsidiaries' assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date.

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 11). 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 initially recorded 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 to reduce the carrying value of the investments to the market value of the shares held.

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 United States, 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 to the profit and loss account 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 The Group follows the principles of FRS 5 Application Note G in determining appropriate revenue recognition policies. In principle, therefore, revenue is recognised to the extent that the Group has obtained the right to consideration through its performance. The adoption of FRS 5 Application Note G has had no impact on amounts received as revenue in this or the previous year.

Turnover (excluding VAT) comprises the value of sales of licences, royalties arising from the resulting sale of licensees' ARM-based products, revenues from support, maintenance and training, and consulting contracts and the sale of boards and software toolkits. Revenue from standard licence products which are not modified to meet the specific requirements of each customer is recognised when the product is delivered and accepted by the customer.

Many licence agreements are for products which are designed to meet the specific requirements of each customer. Revenue from the sale of such 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 approximates to the extent of performance.

1 Principal accounting policies continued

Where invoicing milestones on licence arrangements are such that the proportion of work performed (calculated on the cost basis described above) is greater than the proportion of the total contract value which has been invoiced, the Group evaluates whether it has obtained, through its performance to date, the right to the uninvoiced consideration and therefore whether revenue should be recognised. In particular it considers:

- whether there is sufficient certainty that the invoice will be raised in the expected timeframe, particularly where the invoicing milestone is in some way dependent on customer activity;
- whether it has sufficient evidence that the customer considers that the Group's contractual obligations have been, or will be, fulfilled;
- whether there is sufficient certainty that only those costs budgeted to be incurred will indeed be incurred before the customer will accept that a future invoice may be raised; and
- the extent to which previous experience with similar product groups and similar customers support the conclusions reached.

Where the Group considers that there is insufficient evidence that it has the right to consideration, taking into account these criteria, revenue is not recognised until there is sufficient evidence that the Group has obtained the right to consideration for its performance under such arrangements.

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.

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.

Certain products have been co-developed by the Group and a collaborative partner, with both parties retaining the right to sell licences to the product. In those cases where the Group makes sales of these products, the total value of the licence is recorded as turnover and the amount payable to the collaborative partner is recorded as cost of sales. Where the collaborative partner makes sales of these products, the Group records as turnover the commission it is due when informed by the collaborative partner that a sale has been made and cash has been collected.

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.

The excess of licence fees and post-contract support invoiced over revenue recognised is recorded as deferred income.

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.

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 are recognised to the extent that they are regarded as recoverable. 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.

1 Principal accounting policies continued

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. In accordance with UITF 38, the Company recognises the assets and liabilities of the ESOP and the QUEST in its own accounts and shares held by the trusts are recorded at cost as a deduction in arriving at shareholders' funds until such time as the shares vest unconditionally to employees (see note 20).

In accordance with the requirements of UITF 17, "Employee share schemes", a charge is made in the profit and loss account representing the fair value at the date of grant of shares awarded under the Group's Long Term Incentive Plan. As the award is conditional on certain performance conditions being met, this is reflected in the number of shares on which the charge is calculated. The charge is credited back to 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 UITF 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 25 a provision is made, calculated using the market price of the Company's shares at the balance sheet date, pro-rated over the vesting period of the options.

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

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

	2003 £000	2002 £000
Europe	**23,118**	26,731
United States	**65,402**	67,086
Asia Pacific	**39,550**	57,105
	128,070	150,922

Turnover by origin

	2003			2002		
	Total sales £000	**Inter-segment sales £000**	**External sales £000**	Total sales £000	Inter-segment sales £000	External sales £000
Europe	**127,297**	**(8,412)**	**118,885**	148,578	(10,831)	137,747
United States	**22,702**	**(17,809)**	**4,893**	29,041	(21,753)	7,288
Asia Pacific	**7,995**	**(3,703)**	**4,292**	9,415	(3,528)	5,887
	157,994	**(29,924)**	**128,070**	187,034	(36,112)	150,922

Profit before taxation, by origin

	2003			2002		
	Operating profit £000	**Interest £000**	**Profit before tax £000**	Operating profit £000	Interest £000	Profit before tax £000
Europe	**14,621**	**4,591**	**19,212**	36,815	4,162	40,977
United States	**1,373**	**9**	**1,382**	1,558	15	1,573
Asia Pacific	**2,445**	**201**	**2,646**	2,756	196	2,952
	18,439	**4,801**	**23,240**	41,129	4,373	45,502

The analysis of operating profit and profit before tax for 2002 is stated after charging exceptional costs of £1,509,000 (Europe), £412,000 (United States) and £39,000 (Asia Pacific).

2 Segmental analysis continued

Net assets

	2003 £000	2002* £000
Europe	**169,305**	159,872
United States	**7,267**	6,787
Asia Pacific	**3,863**	6,322
	180,435	172,981

* The prior year's figures have been restated solely as a result of the adoption of UITF 38, "Accounting for ESOP trusts" (see note 20).

The above analyses of turnover, profit before tax and net assets in 2003 include contributions from the Group's acquisition, ARM Belgium N.V. (formerly Adelante Technologies N.V.), as follows: turnover by destination and origin – Europe: £863,000; profit before tax – Europe: £224,000; net assets – Europe: £1,438,000.

3 Cost of sales, gross profit and operating expenses

In relation to the acquired entity, ARM Belgium N.V., the total figures for continuing operations in 2003 include the following amounts: cost of sales: £nil; gross profit: £863,000; research and development: £1,081,000; sales and marketing: £nil; administrative expenses: £40,000. These figures exclude a credit of £482,000 in relation to the release of the pension provision (see note 18).

4 Directors' emoluments

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

	2003 £	2002 £
Aggregate emoluments in respect of qualifying services	**1,215,278**	1,160,056
Aggregate gains made on exercise of share options	**330,000**	58,240
	1,545,278	1,218,296
Aggregate Group pension contributions to money purchase schemes	**73,913**	73,153
	1,619,191	1,291,449

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

	2003 £	2002 £
Emoluments in respect of qualifying services	**211,710**	211,559
Gains made on exercise of share options	**330,000**	–
	541,710	211,559
Group pension contributions to money purchase schemes	**24,638**	24,188
	566,348	235,747

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

5 Employee information

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

	2003 Number	2002 Number
By activity:		
Research and development	**430**	437
Administration	**96**	100
Sales and marketing	**204**	212
	730	749

	2003 £000	2002 £000
Staff costs (for the above persons):		
Wages and salaries	**35,747**	37,732
Social security costs	**3,584**	3,463
Other pension costs	**1,848**	1,894
	41,179	43,089

In addition to the above, payments in 2002 totalling £1,886,000 were made to employees in respect of redundancy. Additionally, due to a change in pension scheme within ARM Belgium N.V. effected post-acquisition, the pension provision in existence at acquisition has been released to the profit and loss account and the credit of £1,069,000 is not included in the above numbers.

Of the total pension costs above, £47,000 (2002: £nil) remained unpaid at the year end.

6 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging/(crediting):

	2003 £000	2002 £000
Depreciation charge for the year:		
Tangible owned fixed assets	**12,908**	12,463
Amortisation of goodwill	**1,299**	1,352
Amortisation of other intangible assets	**3,342**	2,777
Impairment of fixed asset investments	**622**	826
Profit on disposal of fixed assets	**(6)**	(14)
Auditors' remuneration:		
Audit services		
– statutory audit (Company: £5,000 (2002: £5,000))	**166**	157
– audit-related regulatory reporting	**51**	42
Further assurance services		
– royalty audits	**72**	4
– other advisory work	**13**	7
Tax compliance and advisory work	**87**	37
Hire of plant and machinery – operating leases	**4,433**	1,736
Leased buildings – operating leases	**3,736**	3,463

Fees to other major firms of accountants for non-audit services amounted to £260,000 (2002: £114,000).

Exceptional items in 2002 relate to the cost of payments made for redundancy for 98 employees and for related outplacement services.

7 Tax on profit on ordinary activities

	2003 £000	2002 £000
Current		
UK corporation tax at 30% (2002: 30%)	8,162	12,846
Overseas corporation tax	1,009	1,106
Under/(over) provision in respect of prior years:		
UK corporation tax	72	5
Overseas corporation tax	(18)	(68)
	9,225	13,889
Deferred		
UK deferred tax – origination and reversal of timing differences	(1,622)	(500)
Overseas deferred tax – origination and reversal of timing differences	374	(358)
Subtotal	(1,248)	(858)
	7,977	13,031

The taxation charge for 2003 was reduced by £766,000 (2002: £754,000) 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 £958,000 (2002: £781,000).

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

	2003 £000	2002 £000
Profit on ordinary activities before taxation	23,240	45,502
Taxation charge at UK corporation tax rate of 30%	6,972	13,651
Effects of:		
Under/(over) provision in respect of prior years	54	(63)
Accelerated capital allowances and other timing differences	1,638	692
Permanent differences	1,202	267
Higher average tax rates in overseas countries	(8)	(8)
Losses utilised during the year	(633)	(650)
Current tax charge for the year	9,225	13,889

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

	Deferred tax asset 2003 £000	Deferred tax asset 2002 £000
At 1 January	1,697	839
Asset relating to losses acquired with subsidiary undertaking (see note 22)	640	–
Credited to the profit and loss account	1,248	858
At 31 December	3,585	1,697

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

	Amount recognised		Amount not recognised	
	2003 £000	2002 £000	2003 £000	2002 £000
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	2,844	1,193	–	–
Losses carried forward	395	–	420	544
Other	346	504	83	15
	3,585	1,697	503	559

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.

8 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 £10,546,000 (2002: £772,000).

9 Dividends proposed

	2003 £000	2002 £000
Interim and final proposed of 0.6 pence (2002: nil) per ordinary share	**6,106**	–

The ESOP trust has waived its right to receive dividends of over 0.01 pence per share, and the QUEST has waived its right to receive any dividends. As such, dividends will not be payable on the 5,721,080 shares currently held within these trusts.

10 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 two categories 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 and the contingently issuable shares under the Group's Long Term Incentive Plan (LTIP). For 2003, no shares that have been allocated for awards under the LTIP have been included in the diluted EPS calculation as the performance criteria cannot be measured until the conclusion of the performance period.

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

	2003			2002		
	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	**15,158**	**1,016,484**	**1.5p**	32,239	1,012,295	3.2p
Effect of dilutive securities:						
Options	**–**	**16,797**		–	8,465	
Diluted EPS						
Adjusted earnings	**15,158**	**1,033,281**	**1.5p**	32,239	1,020,760	3.2p

11 Intangible fixed assets

Group	Patents and licences £000	Goodwill £000	Total £000
Cost			
At 1 January 2003	12,245	5,744	17,989
Additions (see note 22)	655	2,380	3,035
At 31 December 2003	**12,900**	**8,124**	**21,024**
Aggregate amortisation			
At 1 January 2003	4,102	4,734	8,836
Charge for the year	3,342	1,299	4,641
At 31 December 2003	**7,444**	**6,033**	**13,477**
Net book value			
At 31 December 2003	**5,456**	**2,091**	**7,547**
At 31 December 2002	8,143	1,010	9,153

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 three years in the case of Allant Software Corporation and Noral Micrologics Limited. Goodwill arising on the current year's acquisitions of ARM Korea Limited and ARM Belgium NV (formerly Adelante Technologies N.V.) is being written off over five years.

The Company does not own any intangible fixed assets.

12 Tangible fixed assets

Group	Freehold buildings £000	Leasehold improvements £000	Computers and software £000	Fixtures, fittings and motor vehicles £000	Total £000
Cost					
At 1 January 2003	190	18,763	41,906	3,101	63,960
Exchange differences	–	(179)	(146)	(67)	(392)
Acquisitions (see note 22)	–	33	756	175	964
Additions	–	1,737	1,803	65	3,605
Disposals	–	(9)	(45)	(72)	(126)
At 31 December 2003	**190**	**20,345**	**44,274**	**3,202**	**68,011**
Aggregate depreciation					
At 1 January 2003	33	8,076	28,304	1,826	38,239
Exchange differences	–	(101)	(121)	(52)	(274)
Acquisitions (see note 22)	–	10	572	71	653
Charge for the year	9	4,539	7,950	410	12,908
Disposals	–	(9)	(44)	(45)	(98)
At 31 December 2003	**42**	**12,515**	**36,661**	**2,210**	**51,428**
Net book value					
At 31 December 2003	**148**	**7,830**	**7,613**	**992**	**16,583**
At 31 December 2002	157	10,687	13,602	1,275	25,721

The Company does not own any tangible fixed assets.

13 Fixed asset investments

Group	Listed investments £000	Other investments £000	Total £000
Cost			
At 1 January 2003*	1,500	4,168	5,668
Additions	1,152	–	1,152
At 31 December 2003	**2,652**	**4,168**	**6,820**
Amounts written off			
At 1 January 2003*	–	1,439	1,439
Amounts written off during the year	–	622	622
At 31 December 2003	**–**	**2,061**	**2,061**
Net book value			
At 31 December 2003	**2,652**	**2,107**	**4,759**
At 31 December 2002*	1,500	2,729	4,229

* As a result of the Group's adoption of UITF 38, amounts relating to the shares held in the Group's ESOP and QUEST are no longer classified as investments and prior year amounts have been restated accordingly (see note 20).

Listed investments During the year the Group participated in a further financing round in Superscape Group plc, a company listed on the London Stock Exchange, maintaining a 12% stake in the company. The cost and market value of this investment as at 31 December 2003 were £2,652,000 and £4,139,000 respectively (2002: £1,500,000 and £1,500,000 respectively). The investment was made in order to broaden the scope of the Group's collaboration with Superscape Group 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 Holdings Limited, a company which develops Bluetooth solutions, and an investment representing 3.2% 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 impairment in value. All these investments are held by ARM Limited.

13 Fixed asset investments continued

Company
The cost and net book value of interests in Group undertakings held by the Company was £2 at 31 December 2003 and 31 December 2002.

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.	US	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	100%
ARM Taiwan Limited	Taiwan	Marketing of RISC-based processors	99.9%
ARM Consulting (Shanghai) Co. Ltd.	PR 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	US	Dormant	100%
ARM France SAS	France	Development of RISC-based processors	100%
ARM Belgium N.V.	Belgium	Development of Data Engine 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.

14 Stocks

Group	**2003 £000**	2002 £000
Finished goods	**931**	1,515

The Company had no stocks at 31 December 2003 and 2002.

15 Debtors

	Group		Company	
	2003 £000	2002 £000	**2003 £000**	2002 £000
Trade debtors	**17,320**	20,516	**–**	–
Amounts owed by Group undertakings	**–**	–	**44,430**	35,091
Other debtors	**1,580**	1,802	**–**	–
Deferred tax (see note 7)	**3,585**	1,697	**–**	–
Prepayments and accrued income	**7,344**	9,543	**207**	249
	29,829	33,558	**44,637**	35,340

All amounts above fall due within one year except that included within prepayments and accrued income is £1,036,000 (2002: £1,606,000) falling due after more than one year.

16 Creditors: amounts falling due within one year

	Group		Company	
	2003 **£000**	2002 £000	**2003** **£000**	2002 £000
Trade creditors	**2,691**	4,730	**–**	–
Corporation tax	**3,140**	3,828	**240**	190
Other taxation and social security	**1,047**	824	**–**	–
Other creditors	**390**	1,027	**–**	–
Accruals and deferred income	**25,563**	21,074	**54**	29
Dividends payable	**6,106**	–	**6,106**	–
	38,937	31,483	**6,400**	219

17 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 its 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 and royalty receipts) 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 2003 the Group had outstanding forward contracts to sell $44,000,000 (2002: $54,000,000). The Group had $28,591,000 (2002: $33,293,000) of trade debtors denominated in US dollars at that date, and US dollar cash balances of $26,340,000 (2002: $28,645,000). Thus 20% (2002: 13%) 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. The Group is also required to settle certain expenses in euros, primarily in its French and Belgian subsidiaries, and as the net 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.

After the year end, the Group has decided to consider the use of other financial instruments such as currency options.

Maximisation of return on funds held on deposit The Group's earnings may be affected by changes in interest rates available on bank deposits. It 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 six 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 2003, the Group made a further investment in Superscape Group plc, a company listed on the London Stock Exchange.

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

External borrowings The Group had no long-term debt and no undrawn committed borrowing facilities at 31 December 2003 (2002: £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.

17 Financial instruments continued

Interest rate risk of financial assets

Group

	2003			2002		
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	**9,063**	**129,421**	**138,484**	89	102,821	102,910
US dollars	**15,663**	**–**	**15,663**	2,452	17,113	19,565
European currencies (other than sterling)	**1,915**	**–**	**1,915**	610	2,473	3,083
Other currencies	**3,482**	**242**	**3,724**	1,140	3,606	4,746
At 31 December	**30,123**	**129,663**	**159,786**	4,291	126,013	130,304
Floating rate	**30,123**	**–**	**30,123**	4,291	–	4,291
Fixed rate	**–**	**129,663**	**129,663**	–	126,013	126,013
At 31 December	**30,123**	**129,663**	**159,786**	4,291	126,013	130,304

The fixed rate cash and short-term investments in sterling and US dollars were placed with banks for between one week and six months and earn interest of between 0.98% and 4.0% (2002: 1.2% and 4.625%). Floating rate cash earns interest based on relevant national LIBID equivalents.

Financial liabilities Provisions for National Insurance and similar taxes of £63,000 (2002: £16,000) 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 £2,015,000 at 31 December 2003 (2002: £1,061,000). The increase is due to changes in the sterling/US dollar exchange rate in 2003.

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 2003: £2,107,000) as they are, by definition, not traded on an organised market and are unique in their activities. However, based on recent fundraising transactions by these companies and, where possible, following review of relevant financial information prepared by the companies, 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 2003. On this basis, the fair value of the Group's listed investment was £4,139,000 at 31 December 2003 (2002: £1,500,000).

Provisions The carrying amount of £63,000 approximates to fair value as this is the amount which would be payable if the liability had crystallized at the balance sheet date.

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.

2003	**US dollars £000**	**European currencies £000**	**Other currencies £000**	**Total £000**
Functional currency of Group operation				
Sterling	**(5,489)**	**1,743**	**23**	**(3,723)**
Other currencies	**377**	**–**	**–**	**377**
Total	**(5,112)**	**1,743**	**23**	**(3,346)**
2002				
Functional currency of Group operation				
Sterling	(729)	1,755	(145)	881
Other currencies	966	–	–	966
Total	237	1,755	(145)	1,847

17 Financial instruments continued

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 2003	–	–	–	1,061	–	1,061
Arising in previous years included in 2003 income	–	–	–	(1,061)	–	(1,061)
Gains and losses not included in 2003 income	–	–	–	–	–	–
Arising in 2003	–	–	–	2,015	–	2,015
Gains and losses on hedges at 31 December 2003	–	–	–	2,015	–	2,015
Of which:						
Gains and losses expected to be included in 2004 income	–	–	–	2,015	–	2,015

Gains deferred at 31 December 2003 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.

18 Provisions for liabilities and charges

The movements in the Group's provisions are as follows:

	Share option tax 2003 £000	**Pension provision 2003 £000**	**Total 2003 £000**	Share option tax 2002 £000
At 1 January	**16**	**–**	**16**	210
Acquired with subsidiary undertaking (see note 22)	**–**	**1,069**	**1,069**	–
Charged/(credited) to the profit and loss account	**47**	**(1,069)**	**(1,022)**	(194)
At 31 December	**63**	**–**	**63**	16

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

Pension provision The pension provision, acquired with ARM Belgium N.V., has been fully released to the profit and loss account post-acquisition following the transfer by all relevant employees from the original defined benefit scheme to a new defined contribution scheme, resulting in the deficit being extinguished.

19 Called-up share capital

Company	**2003 £000**	2002 £000
Authorised		
1,580,000,000 ordinary shares of 0.05 pence each (2002: 1,580,000,000)	**790**	790
Allotted, called-up and fully paid		
1,023,345,650 ordinary shares of 0.05 pence each (2002: 1,021,758,000)	**512**	511

1,587,650 ordinary shares of 0.05 pence each were issued in the year for cash consideration of £254,946. The issue of these shares occurred on the exercise of share options at various times during the year.

19 Called-up share capital continued

Share options The Company had the following ordinary share options outstanding at 31 December 2003:

Date of issue	Ordinary shares of 0.05 pence each Number	Exercise price per share £	Period of option Earliest date	Period of option Latest date
15 July 1996	320,000	0.02	15 July 1999	14 July 2006
5 March 1997	615,000	0.026	5 March 2000	4 March 2007
29 May 1997	20,000	0.0425	29 May 2000	28 May 2004
25 June 1997	20,000	0.0625	25 June 2000	24 June 2004
1 October 1997	120,000	0.0625	1 October 2000	30 September 2004
24 December 1997	230,000	0.0625	24 December 2000	23 December 2004
7 March 1998	400,000	0.1125	7 March 2001	6 March 2008
7 March 1998	5,001	0.1125	7 March 1999	6 March 2005**
8 June 1998	35,000	0.3875	8 June 2001	7 June 2005
8 June 1998	1,504	0.3875	8 June 1999	7 June 2005**
17 August 1998	50,000	0.5275	17 August 2001	16 August 2008
17 August 1998	10,061	0.5275	17 August 1999	16 August 2005**
16 October 1998	51,000	0.405	16 October 2001	15 October 2008
11 March 1999	2,499,887	1.224	11 March 2002	10 March 2009
11 March 1999	4,471,980	1.224	11 March 2002	10 March 2006
11 March 1999	1,194,369	1.224	11 March 2000	10 March 2004**
4 May 1999	120,840	1.338	4 May 2002	3 May 2009
4 May 1999	25,160	1.338	4 May 2002	3 May 2006
4 May 1999	26,252	1.338	4 May 2000	3 May 2004**
10 June 1999*	85,340	1.099	1 July 2004	31 December 2004
10 August 1999	43,495	1.765	10 August 2002	9 August 2009
10 August 1999	3,005	1.765	10 August 2002	9 August 2006
10 August 1999	40,002	1.765	10 August 2000	9 August 2004**
12 November 1999	80,570	4.26	16 November 2002	15 November 2009
12 November 1999	76,680	4.26	16 November 2002	15 November 2006
1 February 2000	89,000	7.738	1 February 2003	31 January 2010
1 February 2000	43,250	7.738	1 February 2003	31 January 2007
1 February 2000	52,500	7.738	1 February 2001	31 January 2005**
18 April 2000	75,215	6.136	18 April 2003	17 April 2010
18 April 2000	36,035	6.136	18 April 2003	17 April 2007
18 April 2000	7,500	6.136	18 April 2001	17 April 2005**
25 April 2000	50,000	6.27	25 April 2001	24 April 2005**
19 May 2000*	597	5.65	1 July 2005	31 December 2005
22 May 2000	272,599	6.155	22 May 2003	21 May 2010
22 May 2000	2,217,329	6.155	22 May 2001	21 May 2007**
22 May 2000	625,000	6.155	22 May 2001	21 May 2005**
7 August 2000	162,500	6.70	7 August 2001	6 August 2007**
7 August 2000	24,250	6.70	7 August 2001	6 August 2005**
13 October 2000	181,250	6.33	13 October 2001	12 October 2007**
13 October 2000	114,500	6.33	13 October 2001	12 October 2005**
13 October 2000	71,250	6.33	13 October 2004	12 October 2007
15 February 2001	396,500	4.43	15 February 2002	14 February 2008**
15 February 2001	83,000	4.43	15 February 2002	14 February 2006**
15 February 2001	30,000	4.43	15 February 2005	14 February 2008
14 May 2001	578,959	3.35	14 May 2004	13 May 2011
14 May 2001	3,472,074	3.35	14 May 2002	13 May 2008**
14 May 2001	1,193,400	3.35	14 May 2002	13 May 2006**
14 May 2001	149,500	3.35	14 May 2005	13 May 2008
19 May 2001*	82,822	3.069	1 July 2004	31 December 2004
19 May 2001*	16,495	3.069	1 July 2006	31 December 2006
22 May 2001	62,909	3.815	22 May 2004	22 May 2008†
1 August 2001	58,813	2.84	1 August 2004	31 July 2011
1 August 2001	20,822	2.84	1 August 2002	31 July 2008**
1 August 2001	28,000	2.84	1 August 2002	31 July 2006**
6 November 2001	139,000	3.75	6 November 2004	5 November 2011
6 November 2001	42,500	3.75	6 November 2002	5 November 2008**
6 November 2001	44,750	3.75	6 November 2002	5 November 2006**
6 November 2001	8,500	3.75	6 November 2005	5 November 2008
5 March 2002	161,250	3.145	5 March 2003	4 March 2009**
5 March 2002	62,500	3.145	5 March 2003	4 March 2007**

19 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
5 March 2002	10,000	3.145	5 March 2006	4 March 2009
19 April 2002	1,061,888	2.465	19 April 2005	18 April 2012
19 April 2002	3,987,212	2.465	19 April 2003	18 April 2009**
19 April 2002	406,896	2.465	19 April 2005	19 April 2009†
19 April 2002	1,371,575	2.465	19 April 2003	18 April 2007**
19 April 2002	162,375	2.465	19 April 2006	18 April 2009
27 May 2002	223,515	2.1475	27 May 2005	26 May 2009**
20 June 2002*	85,646	1.82537	1 July 2005	31 December 2005
20 June 2002*	36,262	1.82537	1 July 2007	31 December 2007
20 June 2002*	15,244	1.82537	1 July 2004	30 September 2004
15 August 2002	305,750	1.505	15 August 2003	14 August 2009**
15 August 2002	125,000	1.505	15 August 2003	14 August 2007**
15 August 2002	5,000	1.505	15 August 2006	14 August 2009
16 October 2002	108,750	0.425	16 October 2003	15 October 2009**
16 October 2002	68,750	0.425	16 October 2003	15 October 2007**
16 October 2002	11,250	0.425	16 October 2006	15 October 2009
8 November 2002	35,000	0.5725	8 November 2003	7 November 2009**
8 November 2002	3,500	0.5725	8 November 2003	7 November 2007**
30 January 2003	3,705,912	0.4375	30 January 2006	29 January 2013
30 January 2003	15,759,867	0.4375	30 January 2004	29 January 2010**
30 January 2003	3,885,711	0.4375	30 January 2006	30 January 2010†
30 January 2003	5,944,771	0.4375	30 January 2004	29 January 2008**
30 January 2003	757,300	0.4375	30 January 2007	29 January 2010
19 June 2003*	4,145,776	0.5865	1 July 2006	31 December 2006
19 June 2003*	634,270	0.5865	1 July 2008	31 December 2008
19 June 2003*	841,945	0.5865	1 July 2005	30 September 2005
25 July 2003	248,250	0.805	25 July 2004	24 July 2010**
25 July 2003	31,000	0.805	25 July 2004	24 July 2008**
5 November 2003	56,500	1.1475	5 November 2004	4 November 2010**
5 November 2003	10,000	1.1475	5 November 2004	4 November 2008**
5 November 2003	3,250	1.1475	5 November 2007	4 November 2010
5 November 2003	243,200	1.1475	1 January 2007	4 November 2010
Total	65,491,080			

* 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.

Under the Group's Long Term Incentive Plan, a further 2,572,646 shares could be awarded to the extent that the performance criteria are satisfied over a three-year period as detailed in the remuneration report. These shares will be awarded from shares already issued within the ESOP.

20 Share premium account and reserves

Group	Share premium account £000	Other reserves £000	Profit and loss account £000
At 1 January 2003, as previously reported	80,883	(663)	93,575
Prior year adjustment	–	–	(2,166)
At 1 January 2003, as restated	80,883	(663)	91,409
Foreign exchange difference on consolidation	–	(1,425)	–
Premium on exercise of share options	254	–	–
Shares allocated to satisfy exercises under SAYE schemes	–	–	263
Credit in respect of employee share awards	–	–	150
Retained profit for the financial year	–	–	9,052
At 31 December 2003	**81,137**	**(2,088)**	**100,874**

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

20 Share premium account and reserves continued

Prior year adjustment The Group has adopted UITF 38, "Accounting for ESOP Trusts", during the year by means of a prior year adjustment. There is no effect on the current or prior year's profit for either the Group or Company. As a result of the change in accounting policy, the cost of own shares held is presented as a deduction in arriving at shareholders' funds. Previously, own shares held were included within investments and were stated at the lower of cost and amounts receivable from the exercise of options, where applicable, and market value. The effect for 2002 is to decrease shareholders' funds and investments at 31 December 2002 by £2,166,000 (£1,438,000 in respect of the ESOP and £728,000 in respect of the QUEST) in both the Group and Company balance sheets. The effect for 2003 is to decrease shareholders' funds and investments at 31 December 2003 by £1,903,000 in both the Group and Company balance sheets.

Own shares held Offset in the profit and loss reserve is an amount of £7,569,000 representing the cost of own shares held. This balance consists of own shares held by the Group's ESOP and QUEST.

Own shares held include £1,438,000 (2002: £1,438,000), being the cost of 5,000,000 (2002: 5,000,000) shares in the Company held by the Group's ESOP. The trust was set up in 1998 and purchased shares at the time of the Company's flotation using funds provided by the Company. Conditional awards under the Group's LTIP have been granted over these shares at 31 December 2003 but no awards have been made since the trust was created. As at 31 December 2003 and 2002, the trust held 5,000,000 shares (nominal value £2,500) with a market value of £6,425,000 at 31 December 2003 (2002: £2,400,000). 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.

Own shares held also include £6,131,000 (2002: £16,596,000), being the cost of 721,080 shares, nominal value £361 (2002: 1,796,754 shares, nominal value £898) 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. Of the £16,596,000 cost of shares held by the QUEST at 31 December 2002, £15,868,000 had originally been contributed by the Company by means of a gift and was written off against the profit and loss reserve in the years in which such contributions were made. The gifted amounts therefore do not form part of the prior year adjustment of £728,000. During the year, 1,075,674 shares (2002: 220,846) were allocated to satisfy employees' and directors' exercises under the Company's Save As You Earn scheme. The market value of the shares at 31 December 2003 was £926,588 (2002: £862,442). 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	Share premium account £000	Profit and loss account £000
At 1 January 2003, as previously reported	80,883	4,324
Prior year adjustment	–	(2,166)
At 1 January 2003, as restated	80,883	2,158
Premium on issue of new shares	254	–
Shares allocated to satisfy exercises under SAYE schemes	–	263
Retained profit for the financial year	–	4,440
At 31 December 2003	**81,137**	**6,861**

21 Reconciliation of movements in Group shareholders' funds

	2003 £000	2002 £000
Profit attributable to shareholders	**15,158**	32,239
Equity dividends proposed	**(6,106)**	–
	9,052	32,239
Other recognised gains and losses relating to the year	**(1,425)**	(807)
Credit in respect of employee share awards	**150**	–
New share capital issued	**1**	4
Shares allocated to satisfy exercises under SAYE schemes	**263**	222
Share premium on issue of new shares	**254**	4,759
Net addition to shareholders' funds	**8,295**	36,417
Opening shareholders' funds as previously reported	**174,306**	138,111
Prior year adjustment (see note 20)	**(2,166)**	(2,388)
Opening shareholders' funds as restated	**172,140**	135,723
Closing shareholders' funds	**180,435**	172,140

22 Acquisition of subsidiary undertaking

In July 2003, the Group acquired 100% of the issued share capital of Adelante Technologies N.V., a Belgian company, for total consideration of £390,000. The following table sets out the book values of the identifiable assets and liabilities acquired and their fair value to the Group:

	Book value £000	Revaluation £000	Accounting policy alignment £000	Fair value to Group £000
Fixed assets				
Tangible	380	(69)	–	311
Current assets				
Debtors	647	–	–	647
Deferred tax asset	–	640	–	640
Cash	23	–	–	23
Total assets	1,050	571	–	1,621
Creditors				
Trade creditors	(135)	–	–	(135)
Accruals and deferred revenue	(434)	–	104	(330)
Provisions				
Pensions	(482)	(587)	–	(1,069)
Total liabilities	(1,051)	(587)	104	(1,534)
Net (liabilities)/assets	(1)	(16)	104	87
Goodwill				303
Satisfied by				
Cash consideration				312
Expenses				78
Total consideration				390

The book value of the assets and liabilities have been taken from the management accounts of the company at the date of acquisition at actual exchange rates on that date. Revaluation adjustments were made to:

- the value of tangible fixed assets to reflect the fair market value of the company's assets;
- the pension provision to increase the liability to £1,069,000 as the scheme had a deficit at the time of acquisition. The scheme was valued on acquisition by qualified actuaries using the projected unit method; and
- to the deferred tax recognised to reflect the anticipated usage of the company's brought forward tax losses.

A fair value adjustment was made to deferred revenue to align the company's revenue recognition policy with that of the Group.

The company's loss after tax for the year ended 31 December 2002 was £1.1 million and for the period from 1 January 2003 until acquisition was £1.3 million.

In April 2003, the Group acquired the minority interest, comprising 15% of issued share capital, of ARM Korea Limited, already a subsidiary undertaking, for cash consideration of £3,023,000. No fair value adjustments were made and goodwill arising on this acquisition amounted to £2,077,000.

The acquisitions have been accounted for using acquisition accounting.

23 Minority interests

	2003 £000	2002 £000
At 1 January	**841**	609
Profit and loss account	**105**	232
Acquisition of minority interest in subsidiary undertaking	**(946)**	–
Equity minority interests at 31 December	**–**	841

During the year, the Group acquired the minority interest in ARM Korea Limited bringing its holding to 100%. Further details are shown in note 22.

24 Reconciliation of operating profit to net cash inflow from operating activities

	2003 £000	2002 £000
Operating profit	**18,439**	41,129
Depreciation on tangible fixed assets	**12,908**	12,463
Profit on sale of tangible fixed assets	**(6)**	(14)
Amortisation of goodwill	**1,299**	1,352
Amortisation of other intangible assets	**3,342**	2,777
Amounts written off unlisted investments	**622**	826
Decrease/(increase) in stocks	**584**	(934)
Decrease in trade debtors	**3,458**	4,293
Decrease/(increase) in prepayments and accrued income	**2,689**	(4,960)
(Decrease)/increase in trade creditors	**(2,468)**	2,369
Increase in other taxation and social security	**223**	40
Increase/(decrease) in accruals, deferred income and other creditors	**2,453**	(7,060)
Movement in provisions for liabilities and charges	**47**	(194)
LTIP compensation charge	**150**	–
Net cash inflow from operating activities	**43,740**	52,087

25 Reconciliation of net cash flow to movement in net funds

	2003 £000	2002 £000
Increase/(decrease) in cash for the year	**27,139**	(5,072)
Cash outflow from purchase of short-term investments	**3,650**	31,637
Change in net funds from cash flows	**30,789**	26,565
Non-cash items:		
Translation difference	**(1,307)**	(728)
Movement in net funds in the year	**29,482**	25,837
Net funds at start of the year	**130,304**	104,467
Net funds at end of the year	**159,786**	130,304

26 Analysis of net funds

	Cash at bank and in hand £000	Short-term investments £000	Total £000
At 1 January 2003	4,291	126,013	130,304
Cash flow	27,139	3,650	30,789
Translation differences	(1,307)	–	(1,307)
At 31 December 2003	**30,123**	**129,663**	**159,786**

27 Cash flow from acquisitions

	2003 £000	2002 £000
Acquisitions		
Purchase of shares	**(3,335)**	–
Acquisition expenses	**(78)**	–
Cash at bank and in hand acquired	**23**	–
Net cash outflow from acquisitions	**(3,390)**	–

28 Capital commitments

Group	2003 £000	2002 £000
Capital expenditure that has been contracted for but has not been provided for in the financial statements	**1,365**	1,714

The Company had no capital commitments at 31 December 2003 and 2002.

29 Financial commitments and contingencies

At 31 December 2003, the Group had annual commitments under non-cancellable operating leases as follows:

	2003		2002	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
Expiring within one year	**285**	**89**	321	8
Expiring between two and five years inclusive	**1,057**	**1,333**	894	1,778
Expiring in over five years	**2,114**	**–**	2,110	–
	3,456	**1,422**	3,325	1,786

At 31 December 2003 and 2002 the Company had no annual commitments under non-cancellable operating leases.

In May 2002, Nazomi Communications Inc. filed suit against ARM alleging wilful infringement of Nazomi's US patent No. 6,332,215 by ARM's Jazelle technology. ARM answered Nazomi's complaint in July 2002, denying infringement of the '215 patent, asserting various affirmative defences and asserting counterclaims. ARM moved for summary judgement and a ruling that the current version of its processor designs incorporating the Jazelle technology does not infringe the '215 patent. The district court granted ARM's motion, holding that the current version of its processor designs incorporating the Jazelle technology does not infringe the '215 patent. Nazomi has appealed the district court's ruling. The appeal court has not set a date to hear the appeal yet. ARM is confident that the original ruling by the district court will be upheld on appeal.

30 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.

During the year, the Group invested a further £1,152,000 in Superscape Group plc, a company in which Mike Inglis is a non-executive director. Additionally, the Group purchased a licence for £500,000 from Superscape Group plc and made cross-licence payments of £453,000 to Superscape Group plc. £392,000 was owed to them at 31 December 2003.

There were no other related party transactions during 2003 or 2002 which require disclosure.

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

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

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. No write-offs of goodwill arose as a result of the Group's impairment reviews.

Amortisation of intangibles Under UK GAAP, intangible assets purchased as part of a business combination are included within the goodwill balance unless the asset can be identified and sold separately without disposing of the business as a whole. Under US GAAP, such intangible assets may meet the criteria set out in SFAS 142, "Goodwill and other intangible assets", for categorisation as intangible assets other than goodwill and are amortised over their useful economic lives. Under US GAAP, payments made to purchase intangible assets that are still in development are charged directly to the profit and loss account. Thus differences arise in the amounts of 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. Where an impairment is considered to be other than temporary, the security is written down through the profit and loss account to a new cost basis represented by the fair value of the security on the date the impairment was determined. Under UK GAAP, the Group's accounting policy is to carry such investments at cost less any provisions for impairment.

Long Term Incentive Plan (LTIP) Under UK GAAP, the fair value of the shares awarded under the LTIP is charged to compensation cost over the period in respect of which performance conditions apply. To the extent the award is adjusted by virtue of performance conditions being met or not, the compensation cost is adjusted in line with this. Under US GAAP, the Group follows variable plan accounting for these grants, measuring compensation expense as the difference between the exercise price and the fair market value of the shares at each period end over the vesting period of the options. Increases in fair market value of the shares result in a charge and decreases in fair market value of the shares result in a credit, subject to the cumulative amount previously expensed.

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. In addition, certain options attract a charge under variable plan accounting under US GAAP.

Employer taxes on 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 UK and 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 during the year. Similarly, in the UK, the Group is entitled to a tax deduction for the profit made by employees on certain options that have been exercised during the year. In both cases, the 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 whilst 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.

Cash 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. Deposits with a maturity at inception of between three months and one year are shown as short-term investments.

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.

31 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

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.

Dividends payable Under UK GAAP, dividends declared after the period end are recorded in the period to which they relate. Under US GAAP, they are recorded in the period in which they are declared.

a) Reconciliation of UK GAAP profit to US GAAP net income

	2003 £000	2002 £000
Profit for the financial year as reported under UK GAAP	**15,158**	32,239
Adjustments for:		
Employer's taxes on share options	**47**	(194)
Compensation charge in respect of SAYE schemes	**(310)**	(56)
Compensation charge in respect of LTIP	**(91)**	–
Write-back of goodwill	**1,299**	1,352
Amortisation of intangibles	**(42)**	–
Embedded derivatives	**(1,141)**	(950)
Tax on UK and US employee share options	**(966)**	(754)
Impairment of marketable security	**(938)**	–
Net income as reported under US GAAP	**13,016**	31,637

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

	2003 £000	2002 £000*
Shareholders' funds as reported under UK GAAP	**180,435**	172,140
Adjustments for:		
Employer's taxes on share options	**63**	16
Cumulative difference on amortisation of goodwill	**2,713**	1,414
Cumulative difference on amortisation of intangibles	**(192)**	(150)
Embedded derivatives	**(2,091)**	(950)
Unrealised gain on marketable security	**1,041**	–
Dividends payable	**6,106**	–
Shareholders' equity as reported under US GAAP	**188,075**	172,470

* The prior year's figures have been restated solely as a result of the adoption of UITF 38, "Accounting for ESOP trusts" (see note 20).

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

	2003 £000	2002 £000
Cash as reported under UK GAAP	**30,123**	4,291
Adjustment for short-term investments treated as cash equivalents under US GAAP	**100,599**	126,013
Cash and cash equivalents as reported under US GAAP	**130,722**	130,304

d) Reconciliation of UK GAAP short-term investments to US GAAP short-term investments

	2003 £000	2002 £000
Short-term investments as reported under UK GAAP	**129,663**	126,013
Adjustment for short-term investments treated as cash equivalents under US GAAP	**(100,599)**	(126,013)
Short-term investments as reported under US GAAP	**29,064**	–

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 ("the Company"), expressed in sterling, set forth on pages 61 to 78 of this report.

Selected consolidated financial data – US GAAP

	1999 £000	2000 £000	2001 £000	2002 £000	**2003** **£000**
Revenues	62,120	100,730	146,274	150,922	**128,070**
Cost of revenues	(9,803)	(11,647)	(17,289)	(13,185)	**(11,022)**
Operating expenses	(36,530)	(57,846)	(82,848)	(96,456)	**(99,785)**
Income from operations	15,787	31,237	46,137	41,281	**17,263**
Interest, net	2,266	3,912	4,470	4,373	**4,801**
Share of loss of equity affiliate	–	(85)	–	–	**–**
Gain on partial disposal of shares in equity affiliate	–	512	–	–	**–**
Minority interest	(64)	(192)	(303)	(232)	**(105)**
Income before income tax	17,989	35,384	50,304	45,422	**21,959**
Provision for income taxes	(1,757)	(6,007)	(16,302)	(13,785)	**(8,943)**
Net income	16,232	29,377	34,002	31,637	**13,016**
Diluted earnings per common share	1.6p	2.9p	3.3p	3.1p	**1.3p**
Research and development as a percentage of revenues	27.6%	26.2%	25.3%	31.3%	**37.6%**
Capital expenditure	£5,900	£11,842	£17,349	£15,616	**£3,605**
Cash, cash equivalents and short-term investments	£51,804	£75,266	£104,467	£130,304	**£159,786**
Shareholders' equity	£67,113	£100,972	£135,845	£172,470	**£188,075**
Total assets	£83,288	£127,343	£175,814	£205,744	**£222,997**
Employees at year end (number)	443	619	722	721	**740**

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 in the semiconductor industry experienced in recent years persisted throughout 2003 and the industry remained competitive. Despite this, the outlook from our partners has developed a more positive tone supported by increased product shipments resulting in increased royalty income for the Company. Both our royalty revenues and units have increased significantly compared with 2002 and quarter on quarter throughout 2003. Partners have remained cautious, though, in licensing new technology and this has had a direct impact on our licensing activity.

The decision in 2002 to adjust our cost base in line with our expectations of short- to medium-term revenue growth has ensured that the Company has remained profitable through 2003, with operating margins also increasing quarter on quarter (excluding one-off legal settlement costs). Despite this decision, we have continued to invest heavily in research and development which has resulted in a variety of new products being released during 2003, including the ARM1156™ and ARM1176™ cores, as well as new features and enhanced functionality with the TrustZone security extension and Thumb-2 core technology.

As well as remaining profitable, the Company has been robustly cash generative, with net cash inflows from operating activity of £38.7 million, giving rise to a year-end cash, cash equivalents and short-term investments balance of £159.8 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 31 December		
	2001 %	2002 %	**2003** **%**
Revenues:			
Product revenues	87.5	88.1	**88.2**
Service revenues	12.5	11.9	**11.8**
Total revenues	100.0	100.0	**100.0**
Cost of revenues:			
Product costs	5.6	4.3	**4.8**
Service costs	6.2	4.4	**3.8**
Total cost of revenues	11.8	8.7	**8.6**
Gross profit	88.2	91.3	**91.4**
Operating expenses:			
Research and development	25.3	31.3	**37.6**
Sales and marketing	14.7	16.4	**17.9**
General and administrative	15.4	14.9	**22.4**
Restructuring costs	–	1.3	**–**
Amortization of goodwill	1.3	–	**–**
Total operating expenses	56.7	63.9	**77.9**
Income from operations	31.5	27.4	**13.5**
Interest, net	3.1	2.9	**3.7**
Minority interest	(0.2)	(0.2)	**(0.1)**
Income before income tax	34.4	30.1	**17.1**
Provision for income taxes	11.1	9.1	**7.0**
Net income	23.3	21.0	**10.1**

Total revenues Total revenues were £128.1 million in 2003, a decrease of 15% from £150.9 million in 2002, which was a 3% increase from £146.3 million in 2001. The actual average dollar exchange rate in 2003 was $1.64 (compared with the effective average rate for ARM of $1.61) compared with £1.50 in 2002. This had the effect of reducing total reported revenues by approximately £9.6 million.

Product revenues Product revenues consist of license fees, sales of development systems and royalties. Product revenues for 2001, 2002 and 2003 were £128.0 million, £132.9 million and £113.0 million, representing 87%, 88% and 88% of total revenues respectively.

License revenues increased from £76.8 million in 2001 to £83.0 million in 2002 and decreased to £50.8 million in 2003 representing approximately 52%, 55% and 40% of total revenues in 2001, 2002 and 2003 respectively.

The continuing importance of the ARM7 family was evident in 2003, accounting for 18% of licensing revenues in 2003, compared with 15% in 2002 and 20% in 2001. This proportion reflected the increasing volume of per-use licenses signed within the Foundry Programme. Revenues from the ARM9 family have declined, accounting for 44% of revenues in 2001, 43% in 2002 and 31% in 2003, partly due to more per-use licenses being taken than full implementation licenses, and partly due to the growing range of other cores available to license from the Company. These include a broadening number of ARM9, ARM10 and ARM11 core family products (including the ARM926 in the Foundry Programme, the ARM 968, ARM1156 and ARM1176), the first core in the next-generation family of ARM products and architectural licenses which give licensees more rights to modify the technology, peripheral technology, models, sub-systems and application software. 51 new licenses were signed in 2003, as well as 26 new licensees bringing the total number of semiconductor partners to 128 at the end of 2003. Of the 51 new licenses, 26 were per-use licenses within 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. Sales of licenses to the existing customer base of semiconductor partners has become a more important part of the business, accounting for more than 90% of total license fees in 2003; this compares with approximately 89% in 2002 and 80% in 2001. These existing partners take licenses to new core families not previously licensed or derivatives of cores already licensed.

The sale of non-core licenses, covering items such as platforms, peripherals, embedded trace modules, models, and sub-systems, decreased in 2003 to £8.9 million from £12.6 million in 2002 and £11.9 million in 2001 representing approximately 18% of license revenues in 2003, 15% in 2002 and 15% in 2001.

Revenues from the sale of Development Systems decreased from £23.3 million in 2001 to £23.1 million in 2002 to £17.9 million in 2003 representing approximately 16%, 15% and 14% of total revenues in 2001, 2002 and 2003 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 2003 was approximately 16% lower than in 2002. Sales of Development Systems have continued to be affected by increased competition in the debug tools marketplace. To assist in the future development of our Development Systems business, we have put in place a new management team and increased resource within this group to progress the products, upgrades and releases available. The first indicators of these actions have shown through in the latter stages of the year and will continue further into 2004.

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 decreased from £27.9 million in 2001 to £26.8 million in 2002, and increased to £44.3 million in 2003, representing 19%, 18% and 34% of total revenues in 2001, 2002 and 2003 respectively. Volume shipments increased from 420 million units in 2001 to 456 million units in 2002, mainly due to increased production of a wide range of electronic devices, including wireless handsets, secure products and automotive products. Unit shipments in 2003 were 782 million, with the increase in volumes coming from all market segments. We have seen the Company becoming less reliant on the wireless sector where, although actual unit shipments have significantly increased in 2003, their contribution has consistently fallen below 70% of total reported units. The consumer entertainment and storage market segments have shown the largest relative growth in the year. The Company expects the trend of increasing proportions of unit shipments into the non-wireless markets to continue into 2004. The Company expects royalty revenues to grow year on year although they may be subject to significant fluctuations from quarter to quarter.

Service revenues Service revenues consist of design consulting services and revenues from support, maintenance and training. Service revenues decreased from £18.3 million in 2001 to £18.0 million in 2002 to £15.1 million in 2003, representing 13%, 12% and 12% of total revenues in 2001, 2002 and 2003 respectively. Consulting revenues decreased from £7.4 million in 2001 to £4.4 million in 2002 and £2.4 million in 2003, as engineering resource was directed away from consulting projects to research and development activities. Revenues from support, maintenance and training increased from £10.9 million in 2001 to £13.6 million in 2002 and decreased to £12.7 million in 2003.

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 2003 was 51% of revenues coming from the US, 19% from Japan, 12% from Asia Pacific, excluding Japan, and 18% from Europe. In 2002, revenues from the US represented 44%, Japan 25%, Asia Pacific, excluding Japan, 13%, and Europe 18%. In 2001, 49% of revenues came from the US, 23% from Japan, 9% from Asia Pacific, excluding Japan, and 19% from Europe.

Product costs Product costs are limited to variable costs of production such as the costs of manufacture of Development Systems, amortization of our third-party technology licenses and cross-license payments to collaborative partners. Product costs were £8.2 million in 2001, £6.5 million in 2002 and £6.2 million in 2003 representing 6%, 4% and 5% of total revenues in 2001, 2002 and 2003 respectively. Approximately two-thirds of total product cost of sales were made up of Development Systems costs in 2003, with the balance comprising additional costs related to the costs of third-party licenses and cross-license payments to collaborative partners. This compares to approximately four-fifths of total product cost of sales being made up of Development Systems costs in 2001 and two-thirds in 2002, with the balance being costs associated with third-party licenses. Product gross margin in 2003 was 95%, compared to 95% in 2002 and 94% in 2001. The Company does not currently expect a significant increase in product costs in 2004, 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 decreased from approximately £9.1 million in 2001 to £6.7 million in 2002 to £4.9 million in 2003. The gross margins earned on service revenues were approximately 50% in 2001, 63% in 2002 and 68% in 2003. In 2003, the Company elected to allocate more engineering resource to research and development activities, thus enabling the Company to develop more innovative products and technologies during the year.

Research and development costs Research and development costs increased from £36.9 million in 2001 to £47.3 million in 2002 and £48.1 million in 2003, representing 25%, 31% and 38% of total revenues in 2001, 2002 and 2003 respectively. Continued investment in research and development remains an essential part of the Company's strategy since the development of new products to license is key to its ongoing success. Key areas of product development for 2004 include the development of further power-saving technologies (OptimoDE and central processing unit (CPU) cores based on symmetric multiprocessor technology), improved security through the TrustZone and SecurJC technologies and developments in superscalar CPU architectures.

Total engineering headcount decreased from 429 at the end of 2001 to 420 at the end of 2002, and was 442 at the end of 2003. The increase in 2003 was predominantly due to the acquisition of ARM Belgium N.V.

Sales and marketing Sales and marketing expenditure increased from £21.5 million in 2001 to £24.7 million in 2002 and was £23.0 million in 2003, representing 15% of total revenues in 2001, 16% in 2002, and 18% in 2003. Headcount in this area increased from 198 at 31 December 2001 to 208 at 31 December 2002, and decreased to 203 at 31 December 2003. 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. Additional sales offices are expected to be opened in India and PR China during 2004.

General and administrative General and administrative headcount decreased from 95 at 31 December 2001 to 93 at 31 December 2002, and was 95 at 31 December 2003. General and administrative costs were £22.5 million in both 2001 and 2002 and increased to £28.7 million in 2003, representing 15%, 15% and 22% of total revenues respectively. Costs in 2003 include £1.6 million of impairments made to investments (2002: £0.8 million; 2001: £0.6 million). Legal costs fluctuated from £5.5 million in 2001 to £2.5 million in 2002 and £9.1 million in 2003 largely as a result of annual variations in the amount of legal expenses relating to patent protection cases and other similar costs. The primary reason for the increase in legal costs from 2002 to 2003 was the provision for settlement of the Herodion arbitration. Expense in relation to provisions for doubtful debts was £1.4 million in 2002, compared with £0.7 million in 2001 and a net release of £1.1 million in 2003. Unrealized future foreign exchange losses on certain committed but not yet invoiced future revenue streams of £1.1 million (2002: £1.0 million; 2001: £nil) were recorded in accordance with SFAS 133. There was a loss on foreign exchange of £0.2 million in 2001, an exchange gain of £0.5 million in 2002 and an exchange gain of £0.9 million in 2003. See "Foreign Currency Fluctuations" below.

Restructuring costs During 2002, the Company incurred restructuring costs of £2.0 million comprising mainly severance payments, substantially all of which were paid during the fourth quarter of 2002 following a reduction in total headcount of 98 people representing 12% of the Company's workforce.

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. There was no charge for goodwill in 2002 or 2003 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 £0.7 million (2002: £0.9 million, 2001: £0.9 million) amortized during 2003. 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, £0.2 million amortized during 2002 and a further £0.2 million amortized during 2003. A further license was purchased in 2002 for £0.2 million. This is being amortized over three years with £0.1 million amortized during 2003. An additional two licenses were purchased in 2003 totalling £0.7 million and these are being amortized over three years with £0.2 million being amortized in the year.

Following the out-of-court settlement 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 four years and £1.5 million was charged to the income statement in 2002 and £2.0 million in 2003.

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 and for 2003 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 receivable fell from £4.5 million in 2001 to £4.4 million in 2002 and increased to £4.8 million in 2003. The growth in interest earned between 2002 and 2003 was due to higher average 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 six months during 2003.

Income before income tax Income before income tax was £50.3 million in 2001, £45.4 million in 2002 and £22.0 million in 2003, representing 34%, 30% and 17% of total revenues respectively. The drop in margins in 2002 was a result of lower than anticipated revenues in the second half of the year, whilst the drop in margin in 2003 was due to lower revenues and higher legal costs (including one-off settlement costs) not being entirely offset by reduced other operating expenses.

Tax charge The Company's effective tax rates were 32.4% in 2001, 30.3% in 2002 and 40.7% in 2003. The effective tax rate fell in 2002 as a result of the Company's ability to claim research and development tax credits for most of the year, but increased in 2003 due to the impact of certain cash and non-cash accounting charges not being deductible for tax purposes.

Liquidity and capital resources The Company's operating activities provided net cash of £52.0 million, £39.5 million and £38.7 million in 2001, 2002 and 2003 respectively. In 2001 the significant items impacting on cash generated from operations were the increase in accounts receivable of £6.6 million and the increase in deferred revenue of £6.7 million. In 2002, accounts receivable decreased £2.9 million while deferred revenues fell by £5.0 million and in 2003 accounts receivable decreased by a further £4.5 million and deferred revenues fell by £3.4 million. Accounts payable in 2003 fell by £2.5 million compared with increases in 2002 and 2001 of £2.4 million and £0.3 million respectively. In 2003 prepaid expenses decreased by £2.8 million, compared with an increase of £5.3 million and £1.4 million in 2002 and 2001 respectively. The Company entered into several leases for design automation tools during 2002, which resulted in the large increase in prepaid expenses, but fell in 2003 as a result of the lease payments being for shorter prepaid periods than in previous years. The Company believes that, given its current level of business, it has sufficient working capital for the foreseeable future.

At 31 December 2003, the Company recorded approximately £11.1 million in deferred revenues which represented cash or receivables scheduled to be recognized as revenues in varying amounts after 31 December 2003. At 31 December 2002 and 31 December 2001, the Company recorded approximately £14.4 million and £19.4 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 2003 was £3.6 million, compared with £15.6 million in 2002 and £17.3 million in 2001. Expenditure in 2001 was high 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. Capital expenditure in 2003 was much lower as a result of the increased leasing of the design automation tools and the much lower level of recruitment. In 2001, £4.0 million was spent on office improvements with £13.4 million spent on computer equipment and software. In 2002, £8.2 million was spent on computer equipment and software and £7.4 million on leasehold improvements and fixtures and fittings. In 2003, £1.8 million was spent on computer equipment and software and £1.8 million on leasehold improvements and fixtures and fittings.

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

In 2003, the Company acquired the 15% minority interest in ARM Korea Limited for cash consideration of £3.0 million bringing its holding to 100%. The Company also acquired the entire share capital of Adelante Technologies N.V. (now renamed ARM Belgium N.V.) for total consideration of £0.4 million.

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.

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 N.V. 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 Group plc, for a consideration of £1.5 million. In 2003 the Company invested a further £1.2 million in Superscape Group plc as part of a further funding round, thus maintaining its 12% holding.

Cash and short-term investment balances at 31 December 2003 were £159.8 million compared to £130.3 million at 31 December 2002. At 31 December 2002, accounts receivable net of allowances for doubtful debts were £20.5 million and £17.3 million at 31 December 2003, which represented 14% 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 $3.0 million in 2001, $7.2 million in 2002, and $4.6 million in 2003. 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 31 December 2001, 2002 and 2003 are disclosed in footnote 13 to the financial statements. The settlement period of the forward contracts outstanding at 31 December 2003 is between 12 January 2004 and 26 March 2004.

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 2003.

Consolidated statements of income and comprehensive income/US GAAP

	2001 £000	2002 £000	**2003 £000**	**2003* $000**
Revenues:				
Product revenues	127,976	132,911	**112,958**	**202,195**
Service revenues	18,298	18,011	**15,112**	**27,050**
Total revenues	146,274	150,922	**128,070**	**229,245**
Cost of revenues:				
Product costs	(8,209)	(6,464)	**(6,171)**	**(11,046)**
Service costs	(9,080)	(6,721)	**(4,851)**	**(8,683)**
Total cost of revenues	(17,289)	(13,185)	**(11,022)**	**(19,729)**
Gross profit	128,985	137,737	**117,048**	**209,516**
Operating expenses:				
Research and development	(36,941)	(47,299)	**(48,131)**	**(86,155)**
Sales and marketing	(21,457)	(24,711)	**(22,960)**	**(41,098)**
General and administrative	(22,521)	(22,486)	**(28,694)**	**(51,362)**
Restructuring costs	–	(1,960)	**–**	**–**
Amortization of goodwill	(1,929)	–	**–**	**–**
Total operating expenses	(82,848)	(96,456)	**(99,785)**	**(178,615)**
Income from operations	46,137	41,281	**17,263**	**30,901**
Interest, net	4,470	4,373	**4,801**	**8,594**
Minority interest	(303)	(232)	**(105)**	**(188)**
Income before income tax	50,304	45,422	**21,959**	**39,307**
Provision for income taxes	(16,302)	(13,785)	**(8,943)**	**(16,008)**
Net income	34,002	31,637	**13,016**	**23,299**
Net income	34,002	31,637	**13,016**	**23,299**
Other comprehensive income:				
Foreign currency adjustments, net of tax	14	(807)	**(1,425)**	**(2,551)**
Unrealised holding (loss)/gain on available-for-sale securities, net of tax	(2,087)	–	**1,979**	**3,542**
Total comprehensive income	31,929	30,830	**13,570**	**24,290**
Basic earnings per common share	3.4p	3.1p	**1.3p**	
Diluted earnings per common share	3.3p	3.1p	**1.3p**	

* US dollar amounts have been translated from sterling at the 31 December 2003 closing rate of £1 = $1.79 and are unaudited (see footnote 1).

All activities relate to continuing operations.

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

Consolidated balance sheets/US GAAP

	2002 £000	**2003 £000**	**2003* $000**
Assets			
Current assets:			
Cash and cash equivalents	130,304	**130,722**	**233,992**
Short-term investments	–	**29,064**	**52,025**
Accounts receivable, net of allowances for doubtful debts of £1,115,000 (2002: £2,193,000)	20,516	**17,320**	**31,003**
Inventory: finished goods	1,515	**931**	**1,666**
Prepaid expenses and other assets	11,345	**8,924**	**15,974**
Total current assets	163,680	**186,961**	**334,660**
Deferred income taxes	1,697	**3,139**	**5,619**
Property and equipment, net	25,721	**16,583**	**29,684**
Intangible assets	10,417	**10,068**	**18,022**
Investments	4,229	**6,246**	**11,180**
Total assets	205,744	**222,997**	**399,165**
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	4,730	**2,691**	**4,817**
Income taxes payable	3,828	**3,140**	**5,621**
Personnel taxes	824	**1,047**	**1,874**
Accrued liabilities	8,636	**16,912**	**30,272**
Deferred revenue	14,415	**11,132**	**19,926**
Total liabilities	32,433	**34,922**	**62,510**
Minority interest	841	**–**	**–**
	33,274	**34,922**	**62,510**
Shareholders' equity			
Ordinary shares: £0.0005 par value; 1,580,000,000 authorized (2002: 1,580,000,000); 1,023,345,650 issued (2002: 1,021,758,000)	511	**512**	**916**
Additional paid-in capital	69,566	**63,321**	**113,345**
Deferred compensation	(313)	**(2,499)**	**(4,473)**
Treasury stock, at cost: 5,721,080 ordinary shares (2002: 6,796,754)	(18,034)	**(7,569)**	**(13,548)**
Retained earnings	121,403	**134,419**	**240,610**
Other comprehensive income:			
Unrealized holding gain on available-for-sale securities, net of tax	–	**1,979**	**3,542**
Cumulative translation adjustment	(663)	**(2,088)**	**(3,737)**
Total shareholders' equity	172,470	**188,075**	**336,655**
Total liabilities and shareholders' equity	205,744	**222,997**	**399,165**

* US dollar amounts have been translated from sterling at the 31 December 2003 closing rate of £1 = $1.79 and are unaudited (see footnote 1).

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

Consolidated statements of cash flows/US GAAP

	2001 £000	2002 £000	**2003 £000**	**2003* $000**
Cash flows from operating activities				
Net income	34,002	31,637	**13,016**	**23,299**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of tangible and intangible assets	12,347	15,240	**16,292**	**29,163**
Stock option compensation	–	56	**551**	**986**
Deferred income taxes	359	(858)	**(1,248)**	**(2,234)**
Tax effect of disqualifying dispositions	428	754	**966**	**1,729**
Provision for doubtful accounts	673	1,393	**(1,078)**	**(1,930)**
Accounts receivable converted to trade investments	(1,361)	–	**–**	**–**
Amount written off investments	613	826	**1,560**	**2,792**
Other	(164)	218	**99**	**177**
Changes in operating assets and liabilities:				
Accounts receivable	(6,569)	2,900	**4,536**	**8,120**
Inventory	(196)	(934)	**584**	**1,045**
Prepaid expenses and other current assets	(1,354)	(5,339)	**2,806**	**5,023**
Accounts payable	312	2,369	**(2,468)**	**(4,418)**
Income taxes payable	5,322	(2,676)	**(688)**	**(1,231)**
Deferred revenue	6,743	(5,005)	**(3,397)**	**(6,080)**
Accrued liabilities and other creditors	613	(1,105)	**6,991**	**12,514**
Personnel taxes	194	40	**223**	**399**
Net cash provided by operating activities	51,962	39,516	**38,745**	**69,354**
Cash flows from investing activities:				
Purchase of equipment	(13,377)	(8,670)	**(1,574)**	**(2,818)**
Purchase of leasehold improvements	(3,972)	(6,946)	**(1,737)**	**(3,109)**
Sale of equipment	71	35	**34**	**61**
Purchase of patent and licenses	(8,568)	(855)	**(655)**	**(1,172)**
Purchase of investments	–	(1,500)	**(1,152)**	**(2,062)**
Purchase of short-term investments	–	–	**(29,064)**	**(52,025)**
Sale of investments	1,936	–	**–**	**–**
Purchase of subsidiaries and businesses, net of cash acquired	(1,351)	–	**(3,390)**	**(6,068)**
Net cash used in investing activities	(25,261)	(17,936)	**(37,538)**	**(67,193)**
Cash flows from financing activities:				
Cash received on issue of shares on exercise of share options	1,558	4,763	**255**	**456**
Proceeds received on issuance of shares	958	222	**263**	**471**
Net cash provided by financing activities	2,516	4,985	**518**	**927**
Effect of foreign exchange on cash and cash equivalents	(16)	(728)	**(1,307)**	**(2,340)**
Net increase in cash and cash equivalents	29,201	25,837	**418**	**748**
Cash and cash equivalents at beginning of the period	75,266	104,467	**130,304**	**233,244**
Cash and cash equivalents at end of the period	104,467	130,304	**130,722**	**233,992**
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	9,643	16,758	**9,925**	
Cash received on interest	4,604	4,187	**4,930**	

* US dollar amounts have been translated from sterling at the 31 December 2003 closing rate of £1 = $1.79 and are unaudited (see footnote 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, 1 January 2001	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, 31 December 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, 31 December 2002	1,021,758,000	511	69,566	(663)	(18,034)	–	(313)	121,403	172,470
Shares issued on exercise of options	1,587,650	1	254						255
Net income								13,016	13,016
Unrealized holding gains on available-for-sale securities						1,979			1,979
Tax effect of disqualifying dispositions			966						966
Deferred compensation arising on share schemes			2,737				(2,737)		–
Amortization of deferred compensation							551		551
Currency translation adjustment				(1,425)					(1,425)
Issuance of shares			(10,202)		10,465				263
Balances, 31 December 2003	**1,023,345,650**	**512**	**63,321**	**(2,088)**	**(7,569)**	**1,979**	**(2,499)**	**134,419**	**188,075**

* 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 31 December 2003 such distributable profits amounted to £6,861,000 after taking into account the proposed dividend of £6,106,000 for 2003.

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 16 October 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 10 March 1998, when its name was changed to ARM Holdings plc. Its initial public offering was on 17 April 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), ARM Belgium N.V. (formerly Adelante Technologies N.V., incorporated in Belgium and acquired and renamed during 2003), 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 UK sterling. Purely for the convenience of the reader, the 31 December 2003 consolidated financial statements have been translated from sterling at the closing rate on 31 December 2003 of £1.00 = $1.79. 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. The results of subsidiaries acquired in the year are included in the income statement from the date they are acquired. On acquisition, all of the subsidiaries' assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date.

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. Other-than-temporary impairment losses and 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 31 December 2003 and 2002, the estimated fair value of these investments approximated their recorded basis, based on estimates determined by management.

Two 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 N.V. during 2001.

During 2002, the Company made a 12% investment in Superscape Group plc, a company listed on the London Stock Exchange. The Company made an additional investment in Superscape Group plc during 2003 maintaining its percentage shareholding.

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 intangible assets purchased as part of a business combination, and such assets are capitalized and amortized over a period of two to five years, being a prudent estimate of the time that the Company is expected to benefit from them, with the exception of in-process research and development which is written off immediately.

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 1 January 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. An annual impairment review in 2003 determined, by way of a comparison of the Company's market capitalization to shareholders' equity, that there was no indication of impairment with respect to goodwill.

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

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.

Certain products have been co-developed by the Company and a collaborative partner, with both parties retaining the right to sell licenses to the product. In those cases where the Company makes sales of these products, the total value of the license is recorded as revenue and the amount payable to the collaborative partner is recorded as cost of sales. Where the collaborative partner makes sales of these products, the Company records as revenue the commission it is due when informed by the collaborative partner that a sale has been made and cash has been collected.

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.

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. Costs include salaries, relevant EDA tools costs and other directly related expenditure as well as a proportion of central facilities costs.

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 31 December 2003 were £226,000 (2002: £199,000; 2001: £268,000) 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 31 December 2001, 2002 and 2003 were £1,591,000, £1,894,000, and £1,848,000 respectively.

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

Short-term investments The Company considers all highly liquid investments with original maturity dates of greater than three months but less than one year to be short-term investments.

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 property and equipment 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 31 December 2003 the loss on exchange is £1,141,000 (2002: £950,000; 2001: £nil).

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

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

Earnings per share Basic earnings per common share is computed based on the weighted average number of ordinary shares. 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 31 December 2003 excludes incremental shares of approximately 18,948,000 (2002: 19,608,000; 2001: 6,258,000) 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 £310,000 and in respect of the LTIP of £241,000 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 certain options issued to 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 defined levels of EPS growth above the rate of inflation over a period of three years, then 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 31 December		
	2001 £000	2002 £000	**2003 £000**
Net income:			
As reported	34,002	31,637	**13,016**
Deduct: Total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects	(11,610)	(11,165)	**(15,794)**
Add back: Total stock-based compensation expense determined under the intrinsic value-based method	–	56	**551**
Pro forma net income/(loss)	22,392	20,528	**(2,227)**
Basic earnings/(loss) per common share (pence):			
As reported	3.4p	3.1p	**1.3p**
Pro forma	2.2p	2.0p	**(0.2p)**
Diluted earnings/(loss) per common share (pence):			
As reported	3.3p	3.1p	**1.3p**
Pro forma	2.2p	2.0p	**(0.2p)**

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2003, 2002 and 2001: risk-free interest rate of between 3.2% and 4.9% (2002: 5.1%; 2001: 5.1%); expected life of between one and five years; between 60% and 127% (2002: 80%; 2001: 79%) 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 2002, 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 24 January 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 2003 is £310,000 (2002: £56,000). The deferred compensation at 31 December 2003 was £1,081,000 (2002: £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 2003 as a result of these provisions is £109,000 (2002: £nil). The number of options to which variable accounting applies is approximately 950,000 (2002: 980,000).

The Company has an LTIP on which it is also required to recognize a compensation charge under the EITF, calculated as the difference between the exercise price and the fair market value of the shares at the period end, over the vesting period of the options. During 2003, a charge of £241,000 was incurred and deferred compensation at 31 December 2003 was £1,418,000

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

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 16 April 1998 to facilitate the recruitment, retention and motivation of employees. Under the group's Long Term Incentive Plan, 2,572,646 shares could be awarded from shares already issued within the ESOP. The market value of unearned shares at 31 December 2003 was £6,425,000.

All costs relating to the schemes are recognized in the income statement as they accrue and the ESOP has waived the right to receive dividends of over and above 0.01 pence per share on all shares held. For the purpose of earnings per share calculations, the shares are treated as canceled until such time as they vest unconditionally.

Treasury stock held also includes £6,131,000 relating to 721,080 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 2003, 2002 or 2001.

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.

During 2003, 1,075,674 shares (2002: 220,846) 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 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 the 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 31 January 2003 and as of 1 January 2004 to variable interest entities in which an enterprise holds a variable interest that it acquired before 1 February 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.

In May 2003, the FASB issued SFAS No. 150 (SFAS 150), "Accounting for certain financial instruments with characteristics of both liabilities and equity". The statement addresses the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity and requires that these instruments be classified as liabilities in statements of financial position. This statement is effective prospectively for financial instruments entered into or modified after 31 May 2003 and otherwise is effective at the beginning of the first interim period beginning after 15 June 2003. This statement shall be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. The adoption of SFAS 150 has not, to date, had any significant impact on the Company's financial position or results of operations.

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 31 December 2001 and 2002 have been, and those for the year ended 31 December 2003 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

During the year, the Company invested a further £1,152,000 in Superscape Group plc, a company in which Mike Inglis is a non-executive director. Additionally, the Company purchased a license for £500,000 from Superscape Group plc and made cross-license payments of £453,000 to Superscape Group plc. £392,000 was owed to them at 31 December 2003.

3 Income taxes

Income before income tax is analyzed as follows:

	Year ended 31 December		
	2001 £000	2002 £000	**2003 £000**
United Kingdom	46,394	40,646	**16,356**
Foreign	3,910	4,776	**5,603**
	50,304	45,422	**21,959**

The provision for income taxes consisted of:

	Year ended 31 December		
	2001 £000	2002 £000	**2003 £000**
Current:			
United Kingdom	14,502	12,852	**8,434**
Foreign	1,441	1,791	**1,447**
Total current	15,943	14,643	**9,881**
Deferred:			
United Kingdom	268	(500)	**(1,622)**
Foreign	91	(358)	**684**
Total deferred	359	(858)	**(938)**
Total provision for income taxes	16,302	13,785	**8,943**

Included in the payable for income taxes is a current tax benefit of £656,000 (2002: £814,000; 2001: £282,000) and a deferred tax charge of £310,000 (2002: credit of £60,000; 2001: charge of £146,000) in relation to employee stock options. Such benefits are reflected as additional paid-in capital.

Total income tax expense differs from the amounts computed by applying the UK statutory income tax rate of 30% for 2003, 2002 and 2001 to income before income tax as a result of the following:

	Year ended 31 December		
	2001 £000	2002 £000	**2003 £000**
UK statutory rate 30% (2002: 30%; 2001: 30%)	15,091	13,627	**6,588**
Permanent differences – other*	1,150	186	**1,803**
Differences in statutory rates of foreign countries	99	115	**92**
Other, net	(38)	(143)	**460**
	16,302	13,785	**8,943**

* Permanent differences comprise permanent adjustments and the UK research and development tax credit.

Significant components of the deferred tax assets are as follows:

	Year ended 31 December		
	2001 £000	2002 £000	**2003 £000**
Fixed asset temporary differences	584	1,193	**2,844**
Temporary difference on available-for-sale securities	–	–	**(446)**
Non-deductible accruals and reserves	255	519	**429**
Losses carried forward	1,397	544	**815**
Total deferred tax assets	2,236	2,256	**3,642**
Valuation allowance	(1,397)	(559)	**(503)**
Net deferred tax assets	839	1,697	**3,139**

UK income taxes have not been provided at 31 December 2003 on unremitted earnings of approximately £6,891,000 (2002: £10,142,000; 2001: £7,401,000) 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 £347,000 (2002: £518,000; 2001: £385,000). The valuation allowance relates to net operating loss carryforwards of certain subsidiaries, where management believes it is more likely than not such amounts will not be realized. None of the loss carryforwards expires before 2018. The future use of the net operating losses carried forward in ARM Inc. may be restricted in the event of a purchase by a third party, whereby the level of losses to be utilized on an annual basis would be limited to 4% of the market value of ARM Inc. at the date of the transaction. There is no such restriction on the losses carried forward in ARM Belgium N.V.

4 Earnings per share

	Year ended 31 December 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 31 December 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

	Year ended 31 December 2003		
	Income £	**Shares Number**	**Per share Amount**
Net income	**13,016,000**		
Basic EPS:			
Income available to common stockholders	**13,016,000**	**1,016,484,029**	**1.3p**
Effect of dilutive securities:			
Stock options		**16,823,410**	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	**13,016,000**	**1,033,307,439**	**1.3p**

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 1 January 2001:

	Year ended 31 December		
	2001 £000	2002 £000	**2003 £000**
Reported net income	34,002	31,637	**13,016**
Add back goodwill amortized	1,929	–	**–**
Adjusted net income	35,931	31,637	**13,016**
Basic earnings per share:			
Reported net income	3.4p	3.1p	**1.3p**
Goodwill amortization	0.2p	–	**–**
Adjusted basic earnings per share	3.6p	3.1p	**1.3p**
Diluted earnings per share:			
Reported net income	3.3p	3.1p	**1.3p**
Goodwill amortization	0.2p	–	**–**
Adjusted diluted earnings per share	3.5p	3.1p	**1.3p**

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 12. At 31 December 2001, 2002 and 2003, no customers accounted for more than 10% of accounts receivable.

As of 31 December 2001, 2002 and 2003, the Company's cash and cash equivalents and short-term investments were deposited with major clearing banks and building societies in the UK in the form of money market deposits for varying periods of up to six months.

6 Acquisitions

In July 2003, the Company purchased the entire share capital of Adelante Technologies N.V. (now ARM Belgium N.V.), a Belgian company, for total consideration of £390,000, comprising £312,000 cash consideration and £78,000 of related acquisition expenses. ARM Belgium N.V. is a developer of data engine processors for data intensive tasks, and will enable ARM to provide innovative IP solutions to meet the growing challenges of our partners.

The following table sets out the fair values of the assets acquired and liabilities assumed at the date of acquisition:

	Fair value to Company £000
Cash and cash equivalents	23
Accounts receivable	647
Total current assets	670
Deferred income taxes	640
Property and equipment, net	311
Intangible assets	302
Goodwill	1
Total assets acquired	1,924
Current liabilities:	
Accounts payable	(135)
Accrued liabilities and deferred revenue	(330)
Pension provision	(1,069)
Total liabilities assumed	(1,534)
Net assets acquired	**390**

Of the £302,000 of acquired intangible assets, £167,000 was assigned to developed technology that is being amortized over five years and £135,000 to customer relationships that is being amortized over two years. The company's loss after tax for the year ended 31 December 2002 was £1.1 million and for the period from 1 January 2003 until acquisition was £1.3 million.

In April 2003, the Company acquired the 15% minority holding in ARM Korea Limited, already a subsidiary undertaking (net assets acquired of £946,000), for cash consideration of £3,023,000, bringing the Company's holding to 100%. Goodwill resulting from this acquisition amounted to £2,077,000. There were no separately identifiable intangible assets.

On 1 February 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 were negligible. Further to this cash consideration, the acquisition agreement provided 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.

The combinations have been accounted for using the purchase method.

7 Investments

In 2002, the Company invested £1,500,000 in Superscape Group plc, an available-for-sale investment. A further £1,152,000 was invested in Superscape Group plc during 2003 as part of a further funding round.

In 2001, the Company disposed of two available-for-sale investments realizing a gain of £655,000.

Impairments during 2003 against unlisted investments held at the year end amounted to £622,000 (2002: £826,000; 2001: £613,000) and against listed investments held at the year end amounted to £938,000.

8 Property and equipment

	31 December	
	2002 £000	**2003 £000**
Owned buildings	190	**190**
Leasehold improvements	18,763	**20,345**
Computers	10,811	**11,168**
Software	31,095	**33,106**
Fixtures, fittings and motor vehicles	3,101	**3,202**
	63,960	**68,011**
Less: accumulated depreciation	(38,239)	**(51,428)**
Property and equipment, net	25,721	**16,583**

Depreciation charged to income for the years ended 31 December 2001, 2002 and 2003 was £9,327,000, £12,463,000 and £12,908,000 respectively.

9 Intangible assets

	Goodwill £000	Patents £000	Licenses £000	Developed technology £000	Customer relationships £000	Total £000
Cost						
At 1 January 2003	5,594	8,196	4,049	–	–	17,839
Additions	2,078	–	655	167	135	3,035
At 31 December 2003	**7,672**	**8,196**	**4,704**	**167**	**135**	**20,874**
Aggregate amortization						
At 1 January 2003	3,320	1,595	2,507	–	–	7,422
Charge for the year	–	2,145	1,197	14	28	3,384
At 31 December 2003	**3,320**	**3,740**	**3,704**	**14**	**28**	**10,806**
Net book value						
At 31 December 2003	**4,352**	**4,456**	**1,000**	**153**	**107**	**10,068**
At 31 December 2002	2,274	6,601	1,542	–	–	10,417

Until the adoption of SFAS 142 on 1 January 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 four to five years, developed technology (the main IP of the company existent at acquisition and generating revenue) over five years and customer relationships (relationships with customers which were generating revenue at acquisition) over two years, being the periods over which the Company is expected to derive benefit from them.

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

	£000
2004	2,700
2005	2,652
2006	266
2007	79
2008	19

10 Shareholders' equity

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

Under the Company's Unapproved Scheme (the "Unapproved 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 Unapproved 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.

There are two further schemes for our French and Belgian employees (the "French Scheme" and the "Belgian Scheme"). In the French Scheme, options are exercisable between four and seven years after their issue, whilst in the Belgian Scheme, options are exercisable from 1 January following the third anniversary after their issue, up to seven years from issue.

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 1999, 2000, 2001, 2002 and 2003 for all employees and executive directors of the Company, which have the same characteristics as those schemes set up in 1998.

	Outstanding options	
	Shares Number	Weighted average exercise price £
Balances, 31 December 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, 31 December 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, 31 December 2002	35,051,349	2.557
Granted in year	37,537,323	0.468
Lapsed in year	(4,434,268)	2.566
Exercised in year	(2,663,324)	0.194
Balances, 31 December 2003	**65,491,080**	**1.455**

The weighted average grant-date fair value of options granted during 2003 was £0.30 for options in the Executive Scheme, £0.27 for options in the Unapproved, ISO, French and Belgian Schemes and £0.45 for sharesave options.

The weighted average exercise price of options exercisable at 31 December 2003 was £2.45 (31 December 2002: £1.71).

10 Shareholders' equity continued

The following options over ordinary shares were in existence at 31 December 2003:

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	**Exercisable at 31 December 2003**
320,000	0.02	2.5 years	1999 – 2006	**320,000**
615,000	0.026	3.2 years	2000 – 2007	**615,000**
20,000	0.0425	0.4 years	2000 – 2004	**20,000**
20,000	0.0625	0.5 years	2000 – 2004	**20,000**
120,000	0.0625	0.8 years	2000 – 2004	**120,000**
230,000	0.0625	1.0 years	2000 – 2004	**230,000**
400,000	0.1125	4.2 years	2001 – 2008	**400,000**
5,001**	0.1125	1.2 years	1999 – 2005	**5,001**
35,000	0.3875	1.4 years	2001 – 2005	**35,000**
1,504**	0.3875	1.4 years	1999 – 2005	**1,504**
50,000	0.5275	4.6 years	2001 – 2008	**50,000**
10,061**	0.5275	1.6 years	1999 – 2005	**10,061**
51,000	0.405	4.8 years	2001 – 2008	**51,000**
2,499,887	1.224	5.2 years	2002 – 2009	**2,499,887**
4,471,980	1.224	2.2 years	2002 – 2006	**4,471,980**
1,194,369**	1.224	0.2 years	2000 – 2004	**1,194,369**
120,840	1.338	5.3 years	2002 – 2009	**120,840**
25,160	1.338	2.3 years	2002 – 2006	**25,160**
26,252**	1.338	1.3 years	2000 – 2004	**26,252**
43,495	1.765	5.6 years	2002 – 2009	**43,495**
3,005	1.765	2.6 years	2002 – 2006	**3,005**
40,002**	1.765	0.6 years	2000 – 2004	**40,002**
80,570	4.26	5.9 years	2002 – 2009	**80,570**
76,680	4.26	2.9 years	2002 – 2006	**76,680**
89,000	7.738	6.1 years	2003 – 2010	**89,000**
43,250	7.738	3.1 years	2003 – 2007	**43,250**
52,500**	7.738	1.1 years	2001 – 2005	**39,375**
75,215	6.136	6.3 years	2003 – 2010	**75,215**
36,035	6.136	3.3 years	2003 – 2007	**36,035**
7,500**	6.136	1.3 years	2001 – 2005	**5,625**
50,000**	6.27	1.3 years	2001 – 2005	**37,500**
272,599	6.155	6.4 years	2003 – 2010	**272,599**
2,217,329**	6.155	3.4 years	2001 – 2007	**1,662,993**
625,000**	6.155	1.4 years	2001 – 2005	**468,750**
162,500**	6.70	3.6 years	2001 – 2007	**121,875**
24,250**	6.70	1.6 years	2001 – 2005	**18,187**
181,250**	6.33	3.8 years	2001 – 2007	**135,937**
114,500**	6.33	1.8 years	2001 – 2005	**85,875**
71,250	6.33	3.8 years	2004 – 2007	**–**
396,500**	4.43	4.1 years	2002 – 2008	**198,250**
83,000**	4.43	2.1 years	2002 – 2006	**41,500**
30,000	4.43	4.1 years	2005 – 2008	**–**
578,959	3.35	7.4 years	2004 – 2011	**–**
3,472,074**	3.35	4.4 years	2002 – 2008	**1,736,037**
1,193,400**	3.35	2.4 years	2002 – 2006	**596,700**
149,500	3.35	4.4 years	2005 – 2008	**–**
62,909†	3.815	4.4 years	2004 – 2008	**–**
58,813	2.84	7.6 years	2004 – 2011	**–**
20,822**	2.84	4.6 years	2002 – 2008	**10,411**
28,000**	2.84	2.6 years	2002 – 2006	**14,000**
139,000	3.75	7.8 years	2004 – 2011	**–**
42,500**	3.75	4.8 years	2002 – 2008	**21,250**
44,750**	3.75	2.8 years	2002 – 2006	**22,375**
8,500	3.75	4.8 years	2005 – 2008	**–**
161,250**	3.145	5.2 years	2003 – 2009	**40,310**
62,500**	3.145	3.2 years	2003 – 2007	**15,625**
10,000	3.145	5.2 years	2006 – 2009	**–**
1,061,888	2.465	8.3 years	2005 – 2012	**–**
3,987,212**	2.465	5.3 years	2003 – 2009	**996,803**

10 Shareholders' equity continued

Ordinary shares Number	Exercise price per share £	Remaining contractual life	Exercise period	**Exercisable at 31 December 2003**
406,896†	2.465	5.3 years	2005 – 2009	–
1,371,575**	2.465	3.3 years	2003 – 2007	**342,893**
162,375	2.465	5.3 years	2006 – 2009	–
223,515†	2.1475	5.4 years	2005 – 2009	–
305,750**	1.505	5.6 years	2003 – 2009	**76,437**
125,000**	1.505	3.6 years	2003 – 2007	**31,250**
5,000	1.505	5.6 years	2006 – 2009	–
108,750**	0.425	5.8 years	2003 – 2009	**27,187**
68,750**	0.425	3.8 years	2003 – 2007	**17,187**
11,250	0.425	5.8 years	2006 – 2009	–
35,000**	0.5725	5.9 years	2003 – 2009	**8,750**
3,500**	0.5725	3.9 years	2003 – 2007	**875**
3,705,912	0.4375	9.1 years	2006 – 2013	–
15,759,867**	0.4375	6.1 years	2004 – 2010	–
3,885,711†	0.4375	6.1 years	2006 – 2010	–
5,944,771**	0.4375	4.1 years	2004 – 2008	–
757,300	0.4375	6.1 years	2007 – 2010	–
248,250**	0.805	6.6 years	2004 – 2010	–
31,000**	0.805	4.6 years	2004 – 2008	–
56,500**	1.1475	6.8 years	2004 – 2010	–
10,000**	1.1475	4.8 years	2004 – 2008	–
3,250	1.1475	6.8 years	2007 – 2010	–
243,200	1.1475	6.8 years	2007 – 2010	–
85,340*	1.099	1.0 years	2004 – 2004	–
597*	5.65	2.0 years	2005 – 2005	–
82,822*	3.069	1.0 years	2004 – 2004	–
16,495*	3.069	3.0 years	2006 – 2006	–
85,646*	1.82537	2.0 years	2005 – 2005	–
36,262*	1.82537	4.0 years	2007 – 2007	–
15,244*	1.82537	0.8 years	2004 – 2004	–
4,145,776*	0.5865	3.0 years	2006 – 2006	–
634,270*	0.5865	5.0 years	2008 – 2008	–
841,945*	0.5865	1.8 years	2005 – 2005	–
65,491,080				**17,749,862**

* 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.

Under the Company's Long Term Incentive Plan, a further 2,572,646 shares could be awarded to the extent that performance criteria are satisfied over a three-year period. These shares will be awarded from shares already issued within the ESOP.

11 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 31 December 2003, are as follows:

Years ending 31 December	Operating leases £000
2004	4,877
2005	3,409
2006	2,357
2007	2,114
2008	2,114
Thereafter	15,606
Total minimum lease payments	30,477

Rental expense under operating leases totalled £3,101,000, £5,199,000 and £8,169,000 for the years ended 31 December 2001, 2002 and 2003 respectively.

In May 2002, Nazomi Communications Inc. filed suit against ARM alleging wilful infringement of Nazomi's US patent No. 6,332,215 by ARM's Jazelle technology. ARM answered Nazomi's complaint in July 2002, denying infringement of the '215 patent, asserting various affirmative defences and asserting counterclaims. ARM moved for summary judgement and a ruling that the current version of its processor designs incorporating the Jazelle technology does not infringe the '215 patent. The district court granted ARM's motion, holding that the current version of its processor designs incorporating the Jazelle technology does not infringe the '215 patent. Nazomi has appealed the district court's ruling. The appeal court has not set a date to hear the appeal yet. ARM is confident that the original ruling by the district court will be upheld on appeal.

Guarantees It is common industry practice for licensors of technology to offer to indemnify their licensees for loss suffered by the licensee in the event that the technology licensed is held to infringe the intellectual property of a third party. Consistent with such practice, the Company provides such indemnification to its licensees but subject, in all cases, to a limitation of liability. The obligation for the Company to indemnify its licensees is subject to certain provisos and is usually contingent upon a third party bringing an action against the licensee alleging that the technology licensed by the Company to the licensee infringes such third party's intellectual property rights. The indemnification obligations typically survive any termination of the license and will continue in perpetuity.

The Company does not provide for any such guarantees unless it has received notification from the other party that they are likely to invoke the guarantee. Any such provision is based upon the directors' estimate of the expected costs of any such claim.

12 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 31 December		
	2001 £000	2002 £000	**2003 £000**
Revenues (by market destination):			
Europe	27,103	26,731	**23,118**
US	72,271	67,086	**65,402**
Japan	33,548	38,295	**24,135**
Asia Pacific excluding Japan	13,352	18,810	**15,415**
Total revenues	146,274	150,922	**128,070**

The Company's exports from the UK were £128,303,000, £135,713,000 and £115,072,000 for the years ended 31 December 2001, 2002 and 2003 respectively.

12 Geographic and segment information continued

	Year ended 31 December 2001 £000	2002 £000	**2003 £000**
Revenues (by origin):			
Europe	131,136	137,747	**118,885**
US	8,431	7,288	**4,893**
Asia Pacific	6,707	5,887	**4,292**
Total revenues	146,274	150,922	**128,070**
Long-lived assets, including deferred income taxes:			
Europe	35,626	38,044	**33,085**
US	3,608	3,751	**2,771**
Asia Pacific	167	269	**180**
Total long-lived assets	39,401	42,064	**36,036**

In 2003, 2002 and 2001 no single customer accounted for more than 10% of total revenues.

13 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, short-term investments 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 31 December					
	2001		2002		**2003**	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000	**Carrying amount £000**	**Fair value £000**
Cash and cash equivalents	104,467	104,467	130,304	130,304	**130,722**	**130,722**
Short-term investments	–	–	–	–	**29,064**	**29,064**
Accounts receivable	24,809	24,809	20,516	20,516	**17,320**	**17,320**
Foreign currency contracts	355	355	1,061	1,061	**2,015**	**2,015**
Embedded derivatives	–	–	(950)	(950)	**(2,091)**	**(2,091)**

14 Post balance sheet events

At the 2004 Annual General Meeting of the Company on 26 April 2004, a dividend of 0.6 pence per share (total cost £6,106,000) will be proposed in respect of the 2003 financial year, and if approved will be paid on 7 May 2004 to shareholders on the register at 2 April 2004.

Report of independent auditors/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 31 December 2003 and 2002 and the results of their operations and their cash flows for the years ended 31 December 2003, 2002 and 2001 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
10 March 2004

Group directory

ARM Holdings plc
110 Fulbourn Road
Cambridge CB1 9NJ
United Kingdom
Tel: +44 (0) 1223 400400
Fax: +44 (0) 1223 400410

ARM Limited
Liberty House
Moorbridge Road
Maidenhead
Berkshire SL6 8LT
United Kingdom
Tel: +44 (0) 1628 427700
Fax: +44 (0) 1628 427701

Sheffield Science Park
New Spring House
231 Glossop Road
Sheffield S10 2GW
United Kingdom
Tel: +44 (0) 114 282 8000
Fax: +44 (0) 114 282 8001

Blackburn Design Centre
Belthorn House
Walker Road
Blackburn BB1 2QE
United Kingdom
Tel: +44 (0) 1254 893900
Fax: +44 (0) 1254 893901

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

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

ARM Belgium
Geldenaaksebaan 329
1st fl.
3001 Leuven-Heverlee
Belgium
Tel: +32 16 391 411
Fax: +32 16 406 076

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

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

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

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

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

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

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

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

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

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

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

ARM Consulting (Shanghai) Co. Ltd
Room 1112–1113
Building B
Far East International Plaza
No. 317 XianXia Road
Shanghai 200051
PR China
Tel: +86 21 62351296
Fax: +86 21 62351207

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

Telephone +44 (0) 1223 400400
Facsimile +44 (0) 1223 400410

Further information available at:
www.arm.com

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