ARM®

Annual report and accounts 2004

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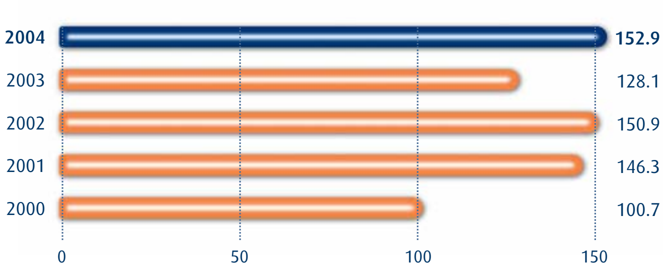
The ARM® architecture lies at the heart of advanced digital products: it enables leading electronics companies to develop reliable total systems solutions for a wide range of applications which are used at home, at work and on the move.

During 2004 we increased our ability to meet our Partners' needs when we acquired Artisan, a designer of physical intellectual property (IP), and Axys, which provides electronic system level design tools. These acquisitions, combined with our continuing investment in R&D and our geographic expansion in India and China are fuelling our drive towards becoming The Architecture for the Digital World™.

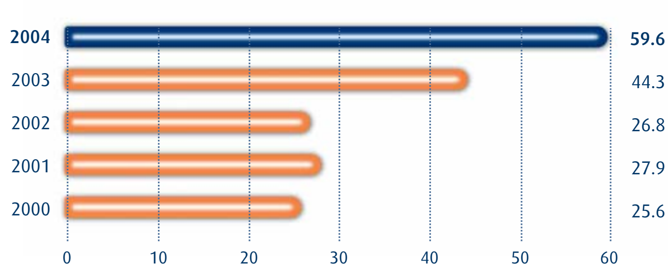
ARM at a glance

- Total revenues of £152.9 million in 2004 compared with £128.1 million in 2003
- Our Partners shipped 1,272 million units based on ARM technology in 2004 (an increase of 63%)
- Continuing high level of R&D expenditure results in introduction of further innovative products
- Licensing of products in ARM11™ family continues to gather momentum
- Technology portfolio broadened into physical IP with the acquisition of Artisan Components, Inc. and into electronic system level design tools with the acquisition of Axys Design Automation, Inc.
- £142.8 million of cash, short- and long-term investments and marketable securities at 31 December 2004
- Increased annual dividend demonstrates confidence in future cash flows

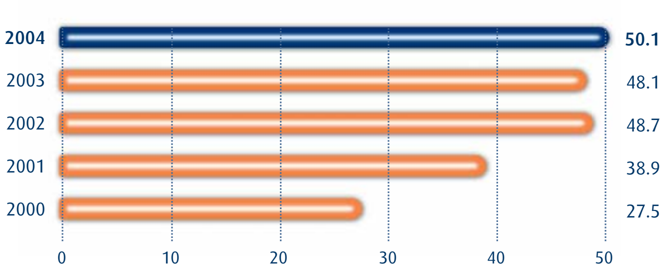
Total revenues (£m)



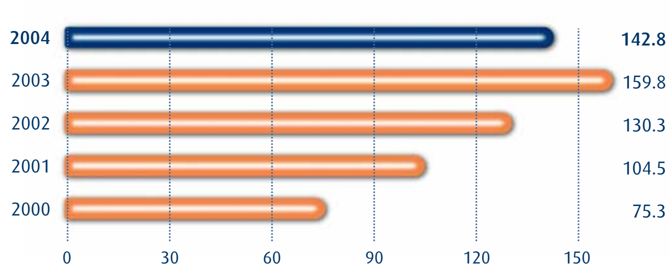
Royalty revenues (£m)



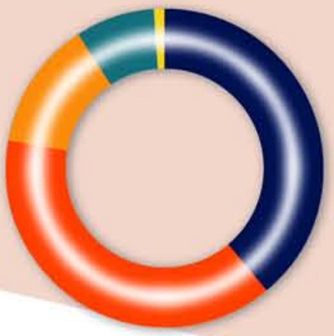
Research and development expenditure (£m)



Net cash balance at year end (£m)

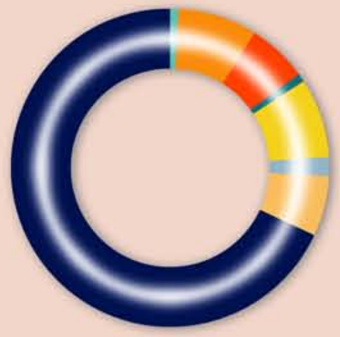


Revenue analysis (%)



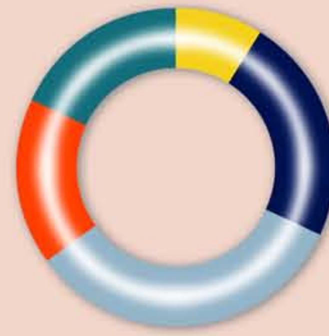
Licensing	39%
Royalties	39%
Development Systems	13%
Support, maintenance and training	8%
Consulting	1%

Royalty units (%)



Automotive	1%
Consumer entertainment	8%
Imaging	6%
Microcontrollers	1%
Networking	8%
Secure	2%
Storage	6%
Wireless	68%

Licence revenues by product (%)



ARM7™ family	9%
ARM9™ family	23%
ARM10™ and architecture	33%
ARM11 family	17%
Non-core licensing	18%

Geographic revenue by market destination

United States 51%

Austin, Texas
Carlsbad, California
Cary, North Carolina
Franklin, California
Irvine, California
Northborough, Massachusetts
Novi, Michigan
Salem, New Hampshire
San Diego, California
Sunnyvale, California

Europe 15%

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

Asia Pacific 34%

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

Chairman's statement

Results and dividend

The increasingly widespread adoption of ARM technology in consumer electronic devices was illustrated in 2004 by the 63% increase in the reported total shipments of ARM Powered® products to 1,272 million units, up from the reported 782 million units in 2003. The strong cash generation resulting from this robust operational performance, together with our confidence in the Company's long-term prospects, enabled us to continue to make significant investments in research and development and to acquire Axys, a provider of electronic system level (ESL) design tools, in August 2004, and Artisan, which designs physical IP components, in December 2004.

The combination of ARM microprocessor IP with the physical IP provided by Artisan, accelerates ARM's momentum towards becoming the architecture for the digital world. It is encouraging that we were able to complete such a strategically important acquisition at the same time as achieving a strong financial performance in the underlying business with a year-on-year dollar revenue increase of more than 30%, operating margins well ahead and year-end order backlog at record levels.

The board 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. As indicated last year, 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 Company's underlying operational performance. With this in mind, the board is recommending a final dividend of 0.42 pence per share, bringing the total for the year to 0.7 pence per share, an increase of 17% over the dividend paid in respect of 2003.

The market

After strong year-on-year growth for the semiconductor industry in 2004, current expectations for 2005 are that there will be little or no growth over 2004. Despite this flatter trading environment, we expect 2005 to be a year of growth in dollar revenues for the Company, underpinned by a high order backlog, strong momentum in royalty revenues and a healthy sales pipeline for our broad technology portfolio.

New products, including our OptimoDE™ embedded signal processing technology and our next-generation microprocessor, codenamed "Tiger", are expected to underpin licensing revenue in 2005.

Geographic expansion

ARM's business is increasingly global. In 2004, 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, 34% from Asia Pacific and 15% from Europe.

During 2004 we established a sales office in Bangalore, India, and our operations there have been enhanced by the addition of Artisan's established design facility in Bangalore. This will be expanded significantly during 2005. We also opened a second office in China. Currently most of the chips which are used in China are bought from our Partners and are designed around our IP, but we are establishing local relationships as the country's high-technology industry matures and its companies begin to develop their own IP.

People

I thank all employees for the contribution made to the excellent results achieved in 2004. I also thank the management and employees of ARM and Artisan who worked tirelessly to make the acquisition happen and are continuing to do so as we embrace the opportunities that rapid and full integration of the businesses will bring.

2004 was a year of strong operational performance, which concluded with completion of our acquisition of Artisan.

It is much to their credit that this was achieved concurrently with delivering a strong operational performance in the increasingly demanding market in which we operate. We were delighted to welcome 26 new employees to ARM with the acquisition of Axys and 347 new employees with the acquisition of Artisan.

Board changes

There have been a number of board changes during 2004 and 2005 which reflect the board's commitment to maintain an appropriate balance of skills and experience. Lawrence Tesler retired from the board at the 2004 Annual General Meeting, having served two three-year terms as a non-executive director. Jeremy Scudamore, who is CEO of Avecia Group (formerly the speciality chemicals business of Zeneca), was appointed as a non-executive director in April and has brought a broad range of skills to the board that extend beyond the semiconductor industry.

With the acquisition of Artisan in December 2004, we were delighted to welcome Mark Templeton and Lucio Lanza to the board. Mark had been CEO of Artisan since he co-founded the business in 1991. He has joined the board as an executive director and General Manager of ARM Physical IP group. Lucio had been a director of Artisan since 1996 and was Chairman from 1997. He has considerable knowledge and experience in the field of electronic design automation and of the semiconductor industry. He has joined the board as a non-executive director and a member of the nomination committee.

Simon Segars and Philip Rowley joined the board in January 2005. Simon joined ARM's engineering team in 1991 and has worked on many ARM CPU products. He was appointed Executive Vice President, Engineering in January 2002 and became Executive Vice President, Worldwide Sales in January 2004. Philip Rowley is President and CEO of AOL Europe and has a strong financial background. He is a qualified chartered accountant and has previously been Group Finance Director of Kingfisher plc, and Executive Vice President and Chief Financial Officer of EMI Music Worldwide. He joined the board as a non-executive director and as a member of the audit committee. These appointments recognise the valuable contribution that Simon is already making to the direction of the business and Philip's broad industry experience, which will further strengthen the non-executive team.

I am delighted that we have been able to recruit such high calibre individuals with such a breadth of skills and experience to the board. These appointments bring the number of directors to 14 and there are no current plans to make further appointments.

Current trading and prospects

The former ARM and Artisan stand-alone businesses both enter 2005 with healthy order backlogs and sales pipelines which underpin licensing revenues this year. In addition, both companies continue to enjoy good growth in royalty revenues, based on the increasing adoption of ARM and Artisan technology by semiconductor and OEM (Original Equipment Manufacturer) companies in recent years. Combined with the healthy order backlog and sales pipeline, this gives us confidence that dollar revenues in both underlying businesses are capable of growing by at least 20% in 2005.

Sir Robin Saxby Chairman

A 32% year-on-year growth in dollar revenues in 2004 and the positive trend in our order backlog indicate that the ARM stand-alone business is in robust shape. We look forward to 2005 with confidence as we start to realise the benefits arising from the acquisition of Artisan at the end of the year.

The year was one of growth and achievement for ARM, both operationally and strategically. Following a year of consolidation in 2003, we increased licensing activity and revenues, made two acquisitions and expanded into new markets. As 2004 ended, the business community was understandably cautious about external factors, such as the weak dollar and the global economic climate, but our achievements during the year demonstrate that we are strongly positioned to continue to flourish in 2005.

Acquisition of Artisan Components, Inc.

We completed the acquisition of Artisan on 23 December 2004; the combined company's product portfolios and sales channel now provide one of the broadest offerings of system-on-chip (SoC) IP to our expanded customer base. We expect the amalgamation of the ARM and Artisan businesses to increase revenue, save costs by consolidating selected corporate functions, deliver an attractive margin structure and generate strong cash flow.

The combined company will seek to leverage Artisan's expertise in physical IP design – the essential building blocks of integrated circuits – with ARM's expertise in designing microprocessors. As a result, we will be able to develop highly-optimised components for use in, and with, our microprocessors, creating the potential to produce substantial benefits for end users, such as reduced power consumption and increased processor speed.

The integration of the businesses is proceeding as planned. The former Artisan business now forms our Physical IP group, and one worldwide sales force is responsible for selling the full range of products. ARM's office in Los Gatos, California, closed in February 2005 and employees relocated to Artisan's Sunnyvale facility, our new US headquarters.

Shipments and licensing activity

The electronics industry in general had a good year with growth across all our key markets. The sales of ARM Powered products provide a powerful indicator of our success: shipments in a single year exceeded the one billion mark for the first time. Total shipments increased 63%, from 782 million in 2003 to 1.3 billion. Most new-generation 3G mobile phones will be ARM Powered and the increasing adoption of the technology has accelerated shipments in this market. There were also significant increases in shipments of ARM Powered digital cameras; storage devices, such as hard disk drives; automotive products and consumer electronics.

Licensing activity was also strong: 65 licences (31 multi-use licences and 34 per-use licences) were signed in 2004, compared with 51 in 2003. Of the 65 licences, 15 were for ARM11 products, 31 for ARM9 products, 15 for ARM7 products, three for next-generation ARM processors and one architecture licence. Fifteen companies became new ARM Partners, bringing the total to 140. Two of our new Partners took multi-use licences and 13 took per-use licences. Total licensing revenues in 2004 were £59.4 million – 39% of total revenues – compared with £50.8 million, or 40%, in 2003.

Licensing activity demonstrated the breadth of our technology offer as well as the longevity of our products. For example, our Partners have been licensing products in the ARM7 family for more than 11 years, and we expect the licensing of ARM7 family products to continue for some time.

The industry's commitment to ARM11 technology, and to complementary ARM technologies such as TrustZone™ security software and Jazelle Java acceleration technology, was emphasised by the 15 new ARM11 licences signed in 2004 (making a total of 25 to date). As ARM11 family products move into the mainstream licensing phase, it is encouraging that licensing of the next generation of ARM technology began in 2004: we signed three Partners for our "Tiger" product. Other new technologies planned for delivery in 2005 are now available for licensing, and we will release details of them during 2005.

The strong licensing performance increased the order backlog in the fourth quarter of the year, with the result that it was approximately 30% higher at the end of 2004 than at the end of 2003. Revenues from licensing of products other than microprocessors comprised 18% of the total in 2004, compared with 17% in 2003.

Product development, new technology and partnerships

The announcement in October 2004 of our new Cortex™ family of microprocessors received an enthusiastic welcome from Partners. Cortex products will enable them to benefit from the incorporation of new features into microprocessors at various performance points. The first member of the family, the ARM Cortex-M3 processor, is targeted at extremely cost-sensitive embedded applications, such as microcontrollers, automotive body systems and white goods.

A further significant technology was announced in May 2004 at the Embedded Processor Forum in San Jose, California. Commonly known as a "data engine", the ARM OptimoDE solution enables flexible, low-cost devices to be designed and developed at performance levels which

cannot be achieved by conventional design. By the end of 2004, we had welcomed the first four licencees of OptimoDE technology, which can be used for any application that requires computationally intensive data and signal processing, including video, wireless LAN, audio, imaging and consumer entertainment. Comprising a configurable data engine (signal processor), together with related IP and tools, it will be used in systems alongside existing ARM technologies, including the electronic system level (ESL) design tools from Axys.

The acquisition of Axys, a provider of fast, accurate, integrated, processor and system modelling and simulation solutions, brings ESL expertise to our RealView® design tools portfolio. The ESL products reduce overall system costs by enabling designs to be modelled early in the development cycle, speeding time-to-market and minimising design errors.

In July we established an Embedded Software group to capitalise on opportunities to generate revenues from software. This team will build on the foundation of the existing Jazelle® Java acceleration technology, Intelligent Energy Manager (IEM) technology, TrustZone security software and Swerve (co-developed with Superscape Group plc) technology. It will bring more focus to the development of enabling software technology to support growth in microprocessor and physical IP licensing, Development Systems and data engines revenues.

In October, we held the first ARM Developers' Conference in Santa Clara. This epitomised the ARM Connected Community: it brought together more than 2,000 delegates and 100 exhibitors from across the world. The attendees all had a common interest – a desire to play a role in the development of solutions based on ARM IP. The event was an unqualified success and we are already organising the 2005 conference.

Revenue and margins

Healthy licensing activity and significant growth in shipments of ARM Powered products had a positive impact. In sterling, revenue rose by 19% compared with 2003; in dollar terms, the growth was even more impressive, at 32%. Effective cost control resulted in our operating profit margin increasing gradually towards our target of around 30%. On the basis of our performance over the past 12 months, we are looking forward with optimism.

People

In the summer of 2004 we accelerated recruitment and, by the end of the year, had 1,171 full-time employees, including 347 who joined the Company as part of the Artisan acquisition, up from 740 in December 2003. The decision to increase headcount was underpinned by our confidence in our potential for growth. We recruited in most areas of the business but, in particular, boosted the Development Systems team and expanded technical sales and marketing. At the year end, the Company had 546 employees in the UK, 454 in the US, 79 in continental Europe, 51 in India and 41 in the Asia Pacific region.

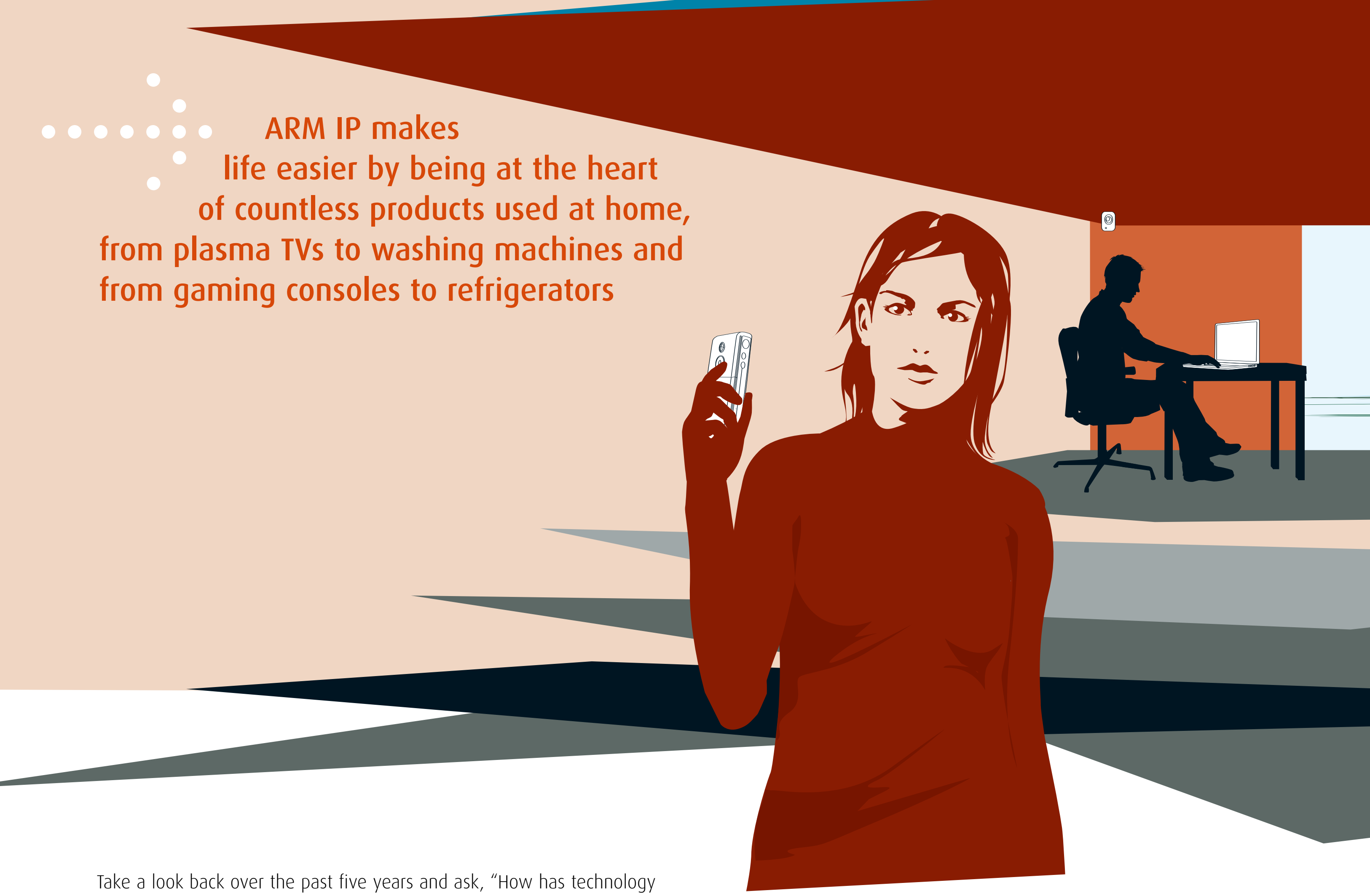
The future

Our investments in important developing markets, combined with the acquisitions of Axys and Artisan, are evidence of our belief that the future offers great opportunities for the development of our business. Together, they will facilitate the design of highly-optimised, cost-effective systems, which incorporate hardware and software, resulting in faster time to revenue for our Partners, their customers and, of course, for us.

The two acquisitions we made in 2004 have set us ahead of the competition. Add to this the momentum from the royalties earned and licences signed in 2004, our ever-expanding Partner network and the exciting new applications currently being developed to run on our processors, and our reasons for optimism are clear.

Warren East.

Warren East Chief Executive Officer



ARM IP makes life easier by being at the heart of countless products used at home, from plasma TVs to washing machines and from gaming consoles to refrigerators

Take a look back over the past five years and ask, "How has technology improved?" It was not that long ago that all but the most expensive TVs were large boxes that took up an entire corner of a room; gaming machines were slow, and mobile phones had monochrome screens and limited battery life.

Naturally, we only know the shortcomings of past technology in retrospect. At the time, not even well-informed consumers knew what future technology would deliver. ARM, on the other hand, had a pretty good idea.

This is because ARM has been a part of the technology innovation for 20 years. Our technology can be found at the heart of countless products. At home, at work and on the move, our IP is playing a central role in the quest for ever faster, less power hungry, more secure, increasingly portable and more compact digital products.

Plasma-screen TVs, for example, are rapidly replacing traditional models. As well as being more stylish, space efficient and offering high-quality audio-visual entertainment, they are increasingly affordable. Similarly, gaming machines offer vastly enhanced performance and capabilities: vivid sound, high-definition graphics and dynamic gameplay. The gaming experience – on consoles and on handheld devices – is a huge improvement over previous models.

The latest generation of mobile phones has redefined the boundaries of wireless communications. 3G technology, which is becoming widely adopted around the world, offers video phone and music download in the palm of the hand.

We have played a significant role, along with our Partners, in the development of these and other technology-based products. Although consumers are unaware of what lies inside the products they use, the world's leading semiconductor manufacturers have licensed our IP and it is their products – the small, yet increasingly powerful, microprocessors – which have enabled greater innovation by the manufacturers of digital devices. This has enabled these companies to create products that appeal to an increasing group of consumers. Whereas technology products used to be confined to specific niches, microprocessors – and, therefore, ARM – are now everywhere.

This is reflected in the royalties that we earn every time an ARM Powered product is shipped. In 2004, shipments exceeded the one billion mark per year and, as microprocessors are used in a wider range of consumer products including white goods such as washing machines and refrigerators, the number and type of ARM Powered products will continue to increase.

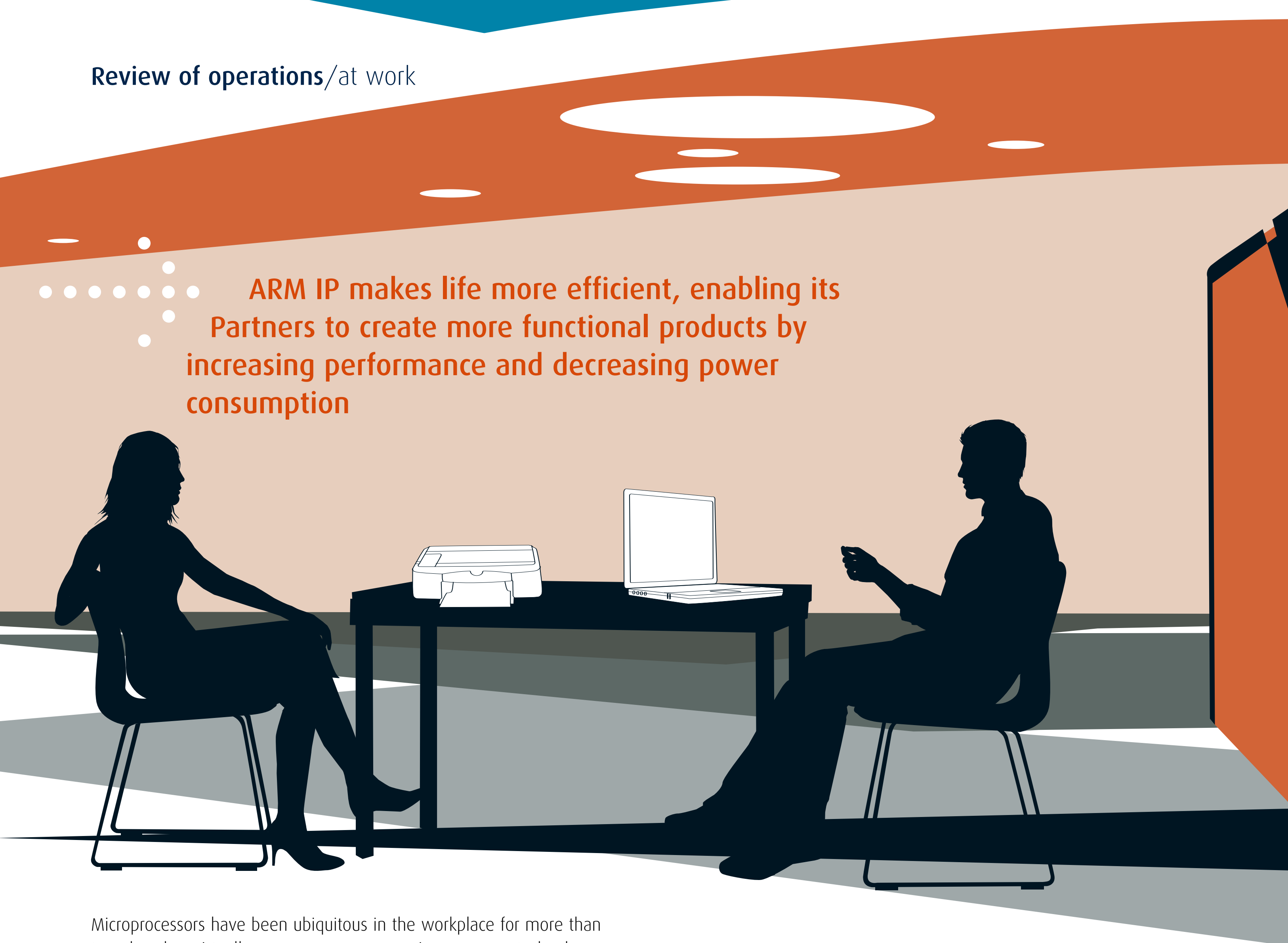
ARM IP is at the heart of many of the digital products used in everyday life. Our technology enables innovative new developments in home entertainment and communications, and can be found in everything from feature-rich mobile phones to next-generation plasma-screen TVs, stereo systems and gaming consoles – even concept products such as an ARM Powered DVD coffee maker.

Our technology is not only present in products used for entertainment, it can be found in many household items that we take for granted such as washing machines, refrigerators and home security systems. ARM IP is central to the microprocessors that power these and similar items.

Manufacturers of digital products are driven by the need to stay ahead of the competition and to respond quickly to consumer demand. As a result, microprocessors must be faster, more versatile, smaller and more energy efficient. Development times for new products shorten every year. Consistently meeting and exceeding such demands is our speciality and our success is derived from the unique relationships we share with our multitude of Partners.

This is illustrated by the ARM Connected Community which now embraces more than 200 Partners from across the technology spectrum. Bringing together many types of technology companies including semiconductor manufacturers, development tools suppliers and operating system (OS) vendors, we provide the foundation for some of the industry's most exciting developments.

Technology is constantly changing, but ARM continues to be devoted to its partnership business model. Through interaction, the sharing of information and ideas and close collaboration, companies across the globe are working with ARM, and one another, to create the next generation of technology-based products for use at home.



ARM IP makes life more efficient, enabling its Partners to create more functional products by increasing performance and decreasing power consumption

Microprocessors have been ubiquitous in the workplace for more than two decades: virtually everyone now uses microprocessor technology on a daily basis. It is not surprising, therefore, that just as our IP powers countless technology products at home, we have a considerable, and increasing presence, in the world of work.

Many ARM Powered products are used at home and at work. Personal digital assistants (PDAs), for example, have become a regular feature of many people's lives and offer a wealth of instantly accessible information. Like so many other technology products, each generation of PDAs is smaller, more powerful and offers greater battery life than its predecessor, and we continue to play a significant role in the ongoing revolution.

Mobile devices offer even greater functionality. Some contain multiple ARM microprocessors: one for processing information, for example, and another for networking functions. In addition, the latest handheld computers are also wireless devices. The adoption of industry standards, such as Bluetooth and WLAN, has helped narrow the gap between the capabilities of mobile and wireless and wireline technologies.

One reason for our success in this, and all markets, is our focus on enabling our Partners to develop increasingly innovative applications based on our architecture. Although we are committed to introducing new IP, our reputation is built on much more than the capabilities of our designs. ARM Development Systems provides a comprehensive range of solutions to help developers make the most of ARM IP. These complement our processors and include software, and hardware tools which are designed to speed time-to-market, while also reducing the risk and cost of development.

In addition, we have partnerships with a wide range of providers of complementary solutions, from suppliers of embedded OS and development environments, to specialists in electronic design automation (EDA), to application software providers. Our partnerships with the leaders in these fields give our silicon Partners considerable advantages in the quest for ever-more innovative products.

By combining our IP with third-party software, our silicon Partners design microprocessors which push the boundaries of performance and power efficiency. The net result for users is greater functionality, improved efficiency and faster communications. The contemporary office communicates like never before. Flexibility and mobility are key factors. Many products, including printers, are now wireless devices. At the same time, they combine scanning and photocopying functions,

The convergence of mobile communication and PDA computing technologies, which is being driven by our Partners' ARM Powered solutions, is making information instantly accessible to everyone, whether in the home or at work.

With the recent advancements in wireless technology, ARM IP is able to play a vital role in bringing freedom and convenience to the workplace. Our technology powers a range of products that can communicate to each other without wires, and that increase the scope of where and how we do business – from handheld computers and smart phones to fax machines and printers.

ARM is also at the heart of the technology that supports and connects people in the traditional workplace environment. Our IP can be found in the IT servers and modems that are used everyday and that we rely on to ensure high-performance and efficiency.

and produce high-quality output in a fraction of the time of previous generations – and at less cost.

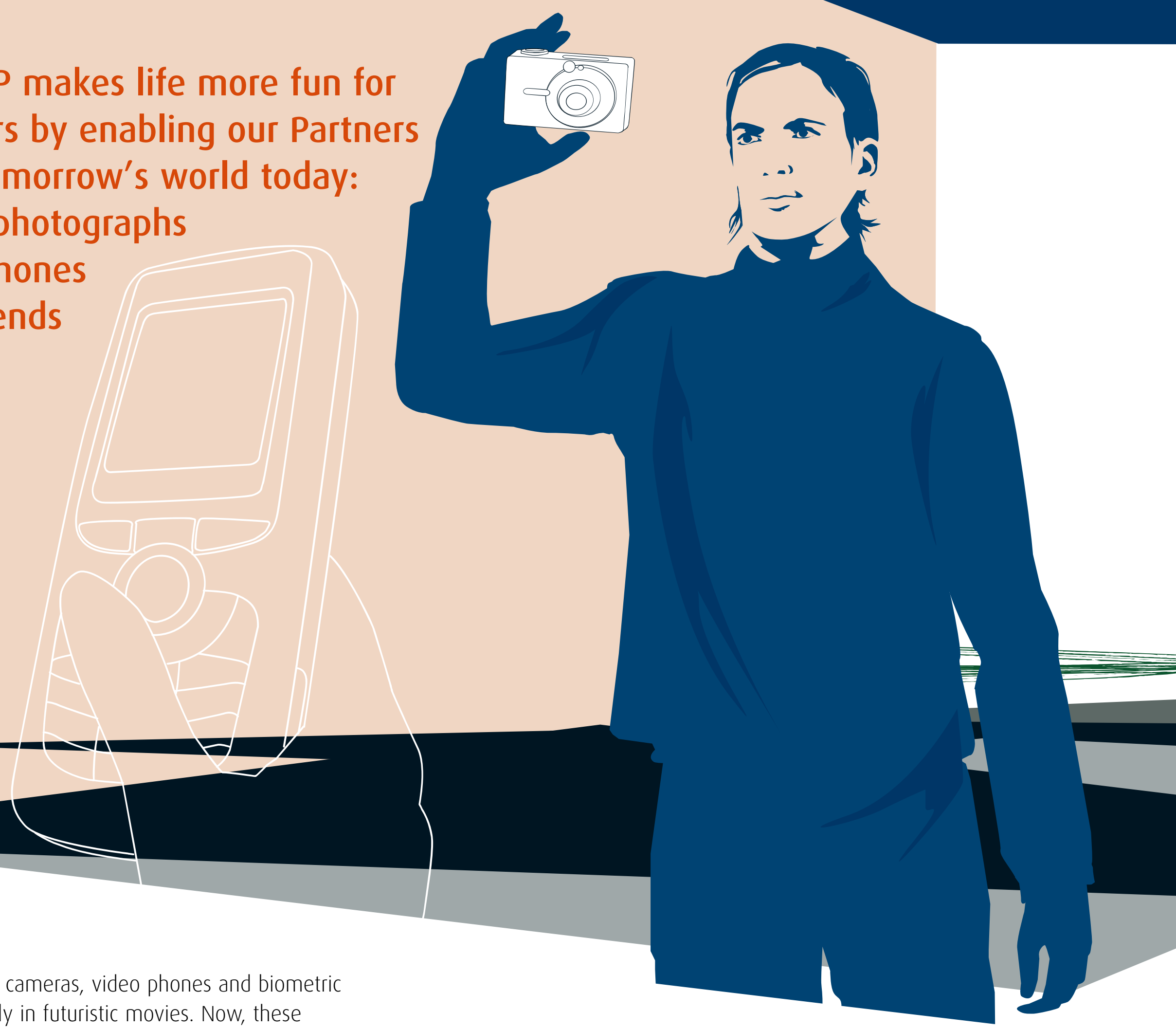
Again, ARM IP is at the heart of the networking and storage markets. ARM Powered products include the servers, modems and firewalls that ensure high performance, reliable and secure connections within and between offices around the world.

Our microproccessors are ideally suited to the storage market, to enable OEMs to pack increasingly large amounts of media into smaller devices. Whether it is a hard disk drive, a memory card or a personal storage device that plugs into a Universal Serial Bus (USB) port, performance and affordability are vital considerations.

ARM Powered products are also found in other work environments. From mobile bar code readers, to electronic test and measurement equipment, and to factory and warehouse automation systems, the ARM architecture is gaining support across an increasingly diverse range of applications.

Each new product that incorporates ARM IP strengthens our connection with the continuing technology revolution that touches everyone's lives. At home and at work, wherever you live and whatever you do, it is likely that you will use an ARM Powered product at some point in your day.

ARM IP makes life more fun for consumers by enabling our Partners to shape tomorrow's world today: now we can take photographs with our mobile phones and talk to our friends through our TVs



Not long ago, pocket-sized video cameras, video phones and biometric identification systems existed only in futuristic movies. Now, these products are commonplace and often ARM Powered, and they confirm that the future of everyday technology is more exciting than ever. When travelling between work and home, enjoying leisure time or simply buying groceries, ARM Powered products play an increasing role in everyday life.

The automotive market is a prime example. By 2007, it is estimated that the average mid-range car will contain up to 70 microprocessors. The latest ARM Powered products in this market include advanced anti-lock braking systems and GPS navigation that provides a 3D view of the road ahead. Our IP has also been used by the creators of a solar-powered car.

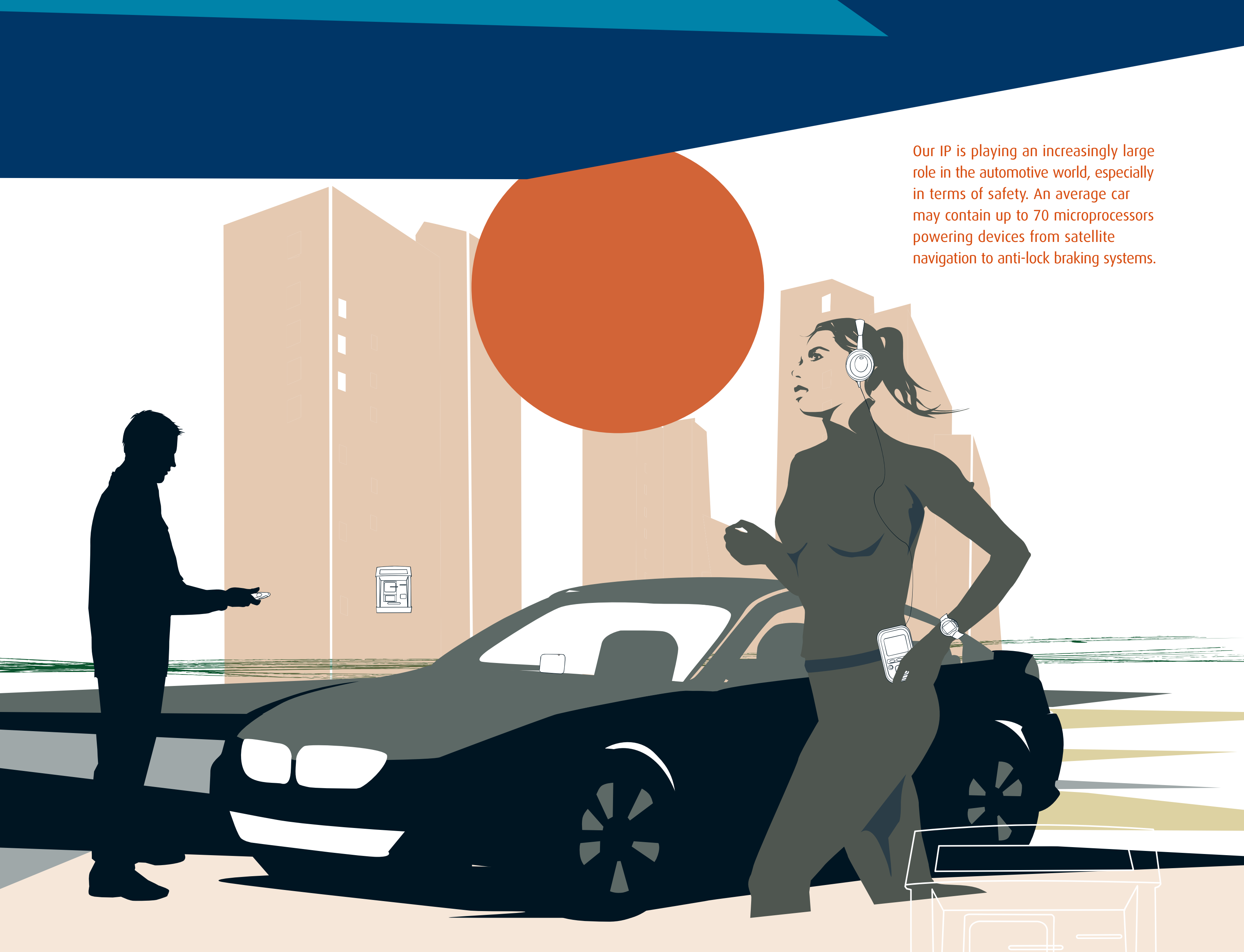
ARM Powered products also protect your money. In the past, bank and credit cards, for example, stored data on a magnetic strip. The new generation of smartcards takes security to a new level with highly-secure microprocessors which greatly reduce the incidence of fraud. Our architecture is also in electronic point-of-sale (EPoS) terminals, PinPads and ATMs.

Security is an increasingly important issue for many people – but so is having fun. Our technology is used as much in portable audio-visual products as it is in the security market.

Some of the world's most advanced digital cameras, for example, are ARM Powered. From affordable models for amateur photographers, to those used by professionals, more and more digital cameras incorporate our architecture. Our IP makes it possible to hold a video conference through the family TV; it also makes it possible to produce digital video cameras the size of a pack of playing cards.

For decades, magnetic tape was a chosen medium for portable sound and vision. A standard audio tape stored 90 minutes of music; now, personal audio players give music lovers on the move immediate access to thousands of songs and hours of enjoyment. The storage capacity of personal audio players is an important buying criterion, but so is size and battery life. On all counts, ARM Powered products have set the standard. Only a few years ago, it would have been impossible to store more than 2,500 songs on any device but now, products which do just that are available. And many, including the market leaders, are based on the ARM architecture.

Our IP is playing an increasingly large role in the automotive world, especially in terms of safety. An average car may contain up to 70 microprocessors powering devices from satellite navigation to anti-lock braking systems.



The ARM architecture is used in many of the most advanced digital cameras and camera phones. Our IP is at the forefront of this field, enabling the development of ever-faster and more compact devices.

Our solutions are not only a part of the visual technology revolution but also the audio, with many market-leading personal audio players now being ARM Powered. We also play a central role in the technology that enables innovative new products such as cardio-vascular monitor watches.

Not only is ARM technology at the heart of your car, it also plays a role in protecting your money. Credit and debit cards, ATMs and PinPads now use microprocessors, many of which are ARM Powered, to store data and to prevent fraud.

Some ARM Powered products combine digital music and still pictures in one device. Indeed, convergence is an irresistible trend in the technology industry. In the same way that technology has crossed the divide between home and work, it has also occupied the space in between.

Technology is now so well established that traditional boundaries between products' functions and where they are used are becoming blurred. As a result, the world's microprocessor manufacturers and the OEMs that design the technology products we use every day are demanding more. These companies need complete solutions which encompass microprocessor IP, physical IP, development tools, software and a host of complementary third-party products. For this reason, ARM is uniquely positioned for the future.

Take a look forward over the next five years and ask "How much will technology change?" Nobody has the definitive answer, but you can be sure ARM has a good idea. We will continue to be at the heart of advanced digital devices – at home, at work and on the move.

In 2004 revenue growth and careful cost control combined to yield strong cash generation from ARM's business. We were also particularly encouraged by the sustained improvement in licensing revenues, demonstrating that ARM continues to develop a broad range of new technologies which bring real benefit to the ARM Connected Community and end customers

The business, its objectives and strategy

ARM designs reduced instruction set computing (RISC) microprocessors and related technology and software and sells Development Systems to enhance the performance, cost-effectiveness and power-efficiency of high-volume embedded applications. The Group licences 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 ARM architecture, to systems companies to incorporate into a wide variety of end products. By creating a network of Partners and working with them to best utilise the Group's technology, ARM's objective is to become the embedded microprocessor architecture for the digital world, establishing the ARM processor for use in many consumer electronic devices, including mobile handsets, MP3 players, digital televisions, hard-disk drives, digital cameras and many automotive applications. The Group intends to grow its revenues and profits by offering an increasingly broad range of IP solutions to its Partners, thereby helping them and their customers to accelerate the time to it takes to get attractive consumer electronic products to market.

ARM made good progress towards achieving its objectives in 2004. As well as reporting strong growth in revenues, profits and cash flows, the Group made two acquisitions which significantly broaden both the technology portfolio offered by the Group and the existing and potential customer base.

Performance

Revenues

Total revenues for the year ended 31 December 2004 amounted to £152.9 million, an increase of 19% over total revenues of £128.1 million in the year ended 31 December 2003. The actual average dollar exchange rate in 2004 was $1.83 (with an effective average exchange rate for ARM of $1.78) compared with $1.64 in 2003. This had the effect of reducing total reported revenues by approximately £13.2 million.

Licensing revenues in 2004 were £59.4 million, being 39% of total revenues, compared with £50.8 million or 40% of total revenues in the year to 31 December 2003. Royalty revenues in 2004 were £59.6 million, representing 39% of total revenues in the year to 31 December 2004, compared with £44.3 million or 34% of total revenues in the year to 31 December 2003. Sales of Development Systems products in 2004 were £19.7 million, being 13% of total revenues, compared with £17.9 million, or 14% of total revenues in 2003. Service revenues, which include consulting services and revenues from support, maintenance and training, were £14.2 million in 2004, representing 9% of total revenues, compared with £15.1 million or 12% of total revenues in 2003.

Royalty revenues and unit shipments

Royalty revenues grew strongly in 2004: they were £59.6 million on 1,272 million units shipped compared with £44.3 million on 782 million units shipped in 2003. Dollar royalty revenues earned in 2004 were $107.1 million, up 50% on 2003 compared with the increase in year-on-year unit shipments of 63%. Over the past three years average royalty rates per unit were 8.4 cents in 2004, 9.1 cents in 2003 and 8.3 cents in 2002, indicating that whilst average royalty rates may move up or down in the short term, they tend to remain stable over a longer period.

In 2004, the proportion of total unit shipments accounted for by the wireless segment was 68%. The 32% relating to the aggregate shipments in all sectors other than wireless represents more than 400 million units in 2004, demonstrating the increasing penetration of ARM technology in the full range of digital products. In 2004, unit shipments grew strongly across all segments with particularly strong growth in the microcontroller, storage and consumer segments.

Gross margin

Gross margin for the year to 31 December 2004 was 92.3% compared with 91.4% in 2003.

Operating expenses

Total operating expenses in the year to 31 December 2004 were £105.9 million compared with £98.6 million in 2003. Operating expenses in 2004 include total non-recurring and acquisition-related charges of £6.6 million, being £2.1 million related to the amortisation of goodwill arising on acquisitions and £4.5 million in respect of a technology licence agreement. Excluding non-recurring and acquisition-related charges, total operating expenses in 2004 were £99.3 million.

Research and development expenses were £50.1 million in 2004, representing 33% of revenues. This compares with £48.1 million, or 38% of revenues, in 2003. Sales and marketing costs in 2004 were £23.9 million, or 16% of revenues, compared with £23.0 million, or 18% of revenues, in 2003. General and administration expenses in 2004 were £31.8 million, including a non-recurring charge of £4.5 million in respect of a technology licensing agreement and £2.1 million of goodwill amortisation. Excluding these non-recurring and acquisition related charges, general and administration expenses in 2004 were

£25.2 million, or 17% of revenues, compared to £19.8 million, or 15% of revenues, before a non-recurring charge of £6.4 million and goodwill amortisation of £1.3 million, in 2003.

Operating margin

The operating margin in 2004 was 23.0% compared with 14.4% in 2003. The operating margin in 2004, excluding non-recurring and acquisition-related charges of £6.6 million, was 27.4% compared to 20.4%, before non-recurring and acquisition-related charges of £7.7 million, in 2003.

Earnings and taxation

Profit before tax in 2004 was £42.2 million compared with £23.2 million in 2003. Profit before tax in 2004, excluding non-recurring and acquisition-related charges of £6.6 million, was £48.8 million, or 32% of revenues, compared with £30.9 million, before non-recurring and acquisition-related charges of £7.7 million, or 24% of revenues, in 2003.

The Group's taxation rate in 2004 is 24.1%, reduced from 34.3% in 2003. The reduction is due primarily to the lower level of disallowable items and increased availability of research and development tax credits in the UK in 2004 compared with 2003.

Fully diluted earnings per share in 2004 were 3.1 pence compared with 1.5 pence in 2003. Earnings per fully diluted share in 2004, before non-recurring and acquisition-related charges of £6.6 million, were 3.6 pence compared with 2.2 pence before non-recurring and acquisition-related charges of £7.7 million, in 2003.

The acquisition of Artisan Components Inc., was completed on 23 December 2004. The 2004 profit and loss account does not include any material trading results in respect of Artisan. However, the balance sheet at 31 December 2004 does reflect the acquisition of Artisan.

Balance sheet and cash flow

Intangible assets at 31 December 2004 were £462.4 million compared with £7.5 million at 31 December 2003, comprising goodwill of £459.4 million and other intangible assets of £3.0 million.

Goodwill arising on the acquisitions of Artisan and Axys amounted to £451.8 million and £8.1 million respectively.

Trade debtors at 31 December 2004 were £28.5 million, including £8.1 million relating to Artisan, compared with £17.3 million at 31 December 2003. The allowance against receivables was £1.5 million at 31 December 2004. Deferred revenues were £22.3 million at 31 December 2004, including £8.2 million relating to Artisan, compared with £11.1 million at the end of 2003.

Resources available

The consolidated cash, short-term investments and long-term marketable securities balance was £142.8 million at 31 December 2004 compared with £159.8 million at 31 December 2003. In 2004, £122.3 million was paid as the cash element of the consideration for the acquisition of Artisan, £3.9 million of fees and expenses were paid in respect of the acquisition of Artisan prior to 31 December 2004 and net cash, short-term investments and long-term marketable securities amounting to £82.6 million were acquired on completion of the Artisan transaction. A further £14 million of fees and expenses related to the Artisan transaction are expected to be paid subsequent to 31 December 2004.

Interest receivable

Interest receivable was £6.9 million for the year to 31 December 2004 compared with £4.8 million in 2003, reflecting the benefit of higher average cash balances and higher interest rates in 2004.

Returns to shareholders

Dividend

The directors recommend payment of a final dividend in respect of 2004 of 0.42 pence per share, which, taken together with the interim dividend of 0.28 pence per share paid in October 2004, gives a total

Selected financial data/UK GAAP

	2004 £000	2003 £000	2002 £000	2001 £000	2000 £000
Turnover	**152,897**	128,070	150,922	146,274	100,730
Cost of sales	**(11,799)**	(11,022)	(13,185)	(17,289)	(11,647)
Gross profit	**141,098**	117,048	137,737	128,985	89,083
Total operating expenses	**(105,877)**	(98,609)	(96,608)	(83,203)	(57,927)
Group operating profit	**35,221**	18,439	41,129	45,782	31,156
Share of loss of associated undertaking	**–**	–	–	–	(85)
Total operating profit	**35,221**	18,439	41,129	45,782	31,071
Net gain on disposals of trade investments	**–**	–	–	314	–
Gain on part disposal of associated undertaking	**–**	–	–	–	512
Interest receivable, net	**6,944**	4,801	4,373	4,470	3,912
Profit on ordinary activities before taxation	**42,165**	23,240	45,502	50,566	35,495
Tax on profit on ordinary activities	**(10,153)**	(7,977)	(13,031)	(15,874)	(6,007)
Profit on ordinary activities after taxation	**32,012**	15,263	32,471	34,692	29,488
Equity minority interest	**–**	(105)	(232)	(303)	(192)
Profit attributable to shareholders	**32,012**	15,158	32,239	34,389	29,296
Dividends	**(8,542)**	(6,106)	–	–	–
Retained profit for the financial year	**23,470**	9,052	32,239	34,389	29,296
Capital expenditure	**5,036**	3,605	15,616	17,349	11,842
Research and development expenditure	**50,133**	48,131	48,674	38,920	27,518
Cash, short- and long-term investments	**142,817**	159,786	130,304	104,467	75,266
Shareholders' funds	**618,528**	180,435	172,140	135,723	98,804
Employees at end of year (number)	**1,171**	740	721	722	619

dividend in respect of 2004 of 0.7 pence per share, an increase of 17% over the total dividend of 0.6 pence per share paid in 2003. Subject to shareholder approval, the final dividend will be paid on 6 May 2005 to shareholders on the register on 1 April 2005.

Capital structure

The authorised share capital of the Company is 2,200,000,000 ordinary shares of 0.05 pence each (2003: 1,580,000,000). The increase was approved by shareholders at an Extraordinary General Meeting held on 23 December 2004 to enable the Company to issue ARM shares to Artisan stockholders as part of the acquisition and to provide a sufficient level of authorised but unissued capital. The issued share capital at 31 December 2004 was 1,350,786,975 ordinary shares of 0.05 pence each (2003: 1,023,345,650).

Treasury policies and objectives and liquidity

The Group has established treasury policies aimed both at mitigating the impact of foreign exchange fluctuations on reported profits and cash flows and at ensuring appropriate returns are earned on the Group's cash resources.

With more than 90% of Group revenues earned in dollars and approximately 45% of Group costs being incurred in dollars, the Group has a significant exposure to movements in the exchange rate between the US dollar and sterling. This exposure is partially mitigated by an ongoing hedging programme, involving forward contracts and low risk option contracts where appropriate.

Principal risks and uncertainties

In line with the guidance for the preparation of an operating and financial review, certain risk factors faced by the Company are identified below. A more detailed description is included in the Company's annual report on Form 20-F and in the Listing Particulars dated 19 November 2004. Details of the Company's internal control and risk management procedures are included in the corporate governance report on page 20.

ARM's quarterly results may fluctuate significantly and be unpredictable which could adversely affect the market price of ARM ordinary shares.

ARM has experienced, and may in the future experience, significant quarterly fluctuations in its results of operations. Quarterly results may fluctuate because of a variety of factors including:

- the timing of entering into agreements with new licencees;
- the mixture of license fees, royalties, revenues from the sale of Development Systems and fees from services;
- the introduction of new technology by ARM, ARM's licensees or ARM's competition;
- the timing of orders from and shipments to systems companies of ARM core-based microprocessors from ARM's semiconductor Partners;
- sudden technological or other changes in the microprocessor industry; and
- new litigation or developments in current litigation.

In future periods, ARM's operating results may not meet the expectations of public market analysts or investors. In such an event, the market price of ARM ordinary shares could be materially adversely affected.

ARM may not realise the anticipated benefits of the acquisition of Artisan

The acquisition involves the integration of two companies that have previously operated independently. There can be no assurance, however, regarding when, or the extent to which, the combined company will be able to realise the benefits anticipated to result from the acquisition, including increased revenues, cost savings or benefits. The combined company must integrate numerous systems, including those involving management information, purchasing, accounting and finance, sales, billing, employee benefits, payroll and regulatory compliance. ARM and Artisan have a number of information systems that are dissimilar, which will have to be integrated, or in some cases, replaced. Difficulties associated with integrating ARM and Artisan, which would be exacerbated because they are headquartered in different countries, could have a material adverse effect on the combined company and the value of ARM ADSs or ARM ordinary shares.

General economic conditions may reduce ARM's revenues and harm ARM's business

ARM is subject to risks arising from adverse changes in global economic conditions. Technology purchases and investments may be delayed or reduced due to economic uncertainties in ARM's key markets. The impact of this on ARM is difficult to predict but if businesses defer licensing ARM's technology, require less services or development tools, or if consumers defer purchases of new products which incorporate ARM's technology (for example, the slower than expected migration to 3G mobile phone technology), ARM's revenue could decline. A decline in revenue would have an adverse effect on ARM's results of operations and could have an adverse effect on ARM's financial condition.

ARM operates in the intensely competitive semiconductor market

The semiconductor market is characterised by price erosion, rapid technological change, short product life cycles, cyclical market patterns and heightened foreign and domestic competition. ARM believes that its future quarterly operating results will continue to be subject to a wide variety of risk factors including those set out above.

Other risks include dependence on semiconductor Partners and systems companies, availability of development tools, systems software and operating systems compatible with the ARM architecture, dependence on a small number of customers and products, dependence on senior management personnel and on hiring and retaining qualified engineers, litigation and threats of litigation and protection of ARM IP.

Tim Score Chief Financial Officer

Directors and advisers

Sir Robin Saxby Warren East Tim Score Tudor Brown Mike Inglis Mike Muller Mark Templeton

Sir Robin Saxby age 58
Chairman
Sir Robin Saxby was involved in founding ARM and joined the Company full-time in February 1991 as President and Chief Executive Officer, becoming Chairman in October 2001. Prior to ARM, he was with ES2, Motorola Semiconductors and Henderson Security Systems Limited. He has also served as Chairman of the Open Microprocessor Initiative Advisory Group, which advised on collaborative R&D activity within Europe. He holds a BEng in Electronics and is a chartered engineer, Hon FIEE and FREng. He has received an honorary doctorate from the University of Liverpool where he is a Visiting Professor, has honorary doctorates from Loughborough University and the University of Essex, and has received the Faraday Medal of the IEE (Institute of Electrical Engineers). He was knighted in the 2002 New Year's Honours List. He currently serves as Deputy President of the IEE, where he is also a trustee. He is a non-executive director of Glotel plc.

Warren East age 43
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. He is a chartered engineer.

Tim Score age 44
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. He is a non-executive director of National Express Group plc.

Tudor Brown age 46
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 45
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. He is a chartered engineer and an MCIM.

Mike Muller age 46
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.

Mark Templeton age 45
General Manager, Physical IP
Mark Templeton joined ARM as General Manager, Physical IP in December 2004 as a result of ARM's acquisition of Artisan. He co-founded Artisan in 1991 and was President and Chief Executive Officer for 13 years. He has been instrumental in driving growth in the IP market through a combination of technical and business innovations. His vision of developing an open community of resources for IC designers – including foundries, EDA vendors, design service companies and IP providers – has proven to be a significant contribution to the IC design and manufacturing industries. Before co-founding Artisan, he held executive positions with Silicon Compiler Systems and Mentor Graphics.

Simon Segars age 37
Executive Vice President, Worldwide Sales
Simon Segars joined the ARM board in January 2005. He was appointed Executive Vice President, Worldwide Sales in January 2004. He was previously EVP of Engineering. He joined ARM in early 1991 and has worked on most of the ARM CPU products since then. He led the development of the ARM7 and ARM9 Thumb® families. He holds a number of patents in the field of embedded CPU architectures.

Simon Segars Peter Cawdron Doug Dunn Lucio L. Lanza Philip Rowley John Scarisbrick Jeremy Scudamore

Peter Cawdron age 61
Senior independent non-executive director
Peter Cawdron joined the ARM board in March 1998. From 1983 to 1997 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 the following UK listed companies, Compass Group plc, The Capita Group plc, Christian Salvesen plc, Arla Foods UK plc, Punch Taverns plc and Johnston Press plc.

Doug Dunn age 60
Independent non-executive director
Doug Dunn joined the ARM board in December 1998. He was previously President and Chief Executive Officer of ASM Lithography Holding N.V. until his retirement in December 2004.
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., Sendo Holdings plc and Soitec S.A.

Lucio L. Lanza age 60
Independent non-executive director
Lucio L. Lanza joined ARM as a non-executive director in December 2004 following ARM's acquisition of Artisan. He was previously a director of Artisan, from 1996, and became Chairman in 1997. He is currently Managing Director of Lanza techVentures, an early stage venture capital and investment firm, which he founded in January 2001. In 1990, he joined US Venture Partners, a venture capital firm, as a venture partner and was a general partner. From 1990 to 1995, he was an independent consultant to companies in the semiconductor, communications and computer-aided design industries, including Cadence Design Systems, Inc. and, from 1986 to 1989, was Chief Executive Officer of EDA Systems, Inc. He is also on the board of directors of PDF Solutions, Inc., a provider of technologies to improve semiconductor-manufacturing yields. He holds a doctorate in electronic engineering from Politecnico of Milano.

Philip Rowley age 52
Independent non-executive director
Philip Rowley joined the ARM board in January 2005. He is President and CEO of AOL Europe, the interactive services, web brands, internet technologies and e-commerce provider. He is a qualified chartered accountant and was Group Finance Director of Kingfisher plc from 1998 to 2001. Prior to that his roles included Executive Vice President and Chief Financial Officer of EMI Music Worldwide.

John Scarisbrick age 52
Independent non-executive director
John Scarisbrick joined the ARM board in August 2001. He had previously worked for 25 years at Texas Instruments (TI) in a variety of roles including as Senior Vice President responsible for TI's $5 billion ASP chip business, President of TI Europe and leading the team that created TI's DSP business in Houston, Texas. Before joining TI, he worked in electronics systems design roles at Rank Radio International and Marconi Space and Defence Systems in the UK. He is Chairman of Cambridge Positioning Systems Ltd and is a non-executive director of CSR plc, SoIM, Intrinsity and Ubinetics.

Jeremy Scudamore age 57
Independent non-executive director
Jeremy Scudamore joined the ARM board in April 2004. He is Chief Executive Officer of Avecia Group (formerly the specialty chemicals business of Zeneca) and previously held senior management positions both in the UK and overseas with Zeneca and ICI. He is a board member of the Chemical Industries Association and England's North West Science Council and is also a member of the DTI's Innovation and Growth Team for the Chemical Industry.

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

Registered number 2548782

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

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

Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA
United Kingdom

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

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

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

Compliance with the Combined Code
The Group complies and complied throughout 2004 with the new 2003 Combined Code appended to the Listing Rules of the Financial Services Authority, with the exception only that the board does not comprise a majority of independent non-executive directors. The board has considered the overall balance between executive and non-executive directors and believes that the number of executive directors is fully justified by the contribution made by each of them. To increase the size of the board further following the appointments made in late December 2004 and early January 2005 to meet this particular provision is not considered appropriate.

Composition and operation of the board
The board currently comprises seven executive directors, six independent non-executive directors and the Chairman. The executive directors are the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer, the Chief Technology Officer, the Executive Vice President, Marketing, the General Manager, Physical IP division and the Executive Vice President, Worldwide Sales, all of whom play significant roles in the day-to-day management of the business. The six 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. The non-executive directors 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 and Jeremy Scudamore both have experience of running large companies in allied industries. Lucio Lanza and John Scarisbrick both have a broad understanding of the Group's technology and the practices of major US-based technology companies. Philip Rowley has a strong financial background and knowledge of internet technologies and e-commerce.

The board had six scheduled meetings during 2004 which were all attended by all the directors, with the exception of the January meeting when Doug Dunn was absent, and the July, November and December meetings when Jeremy Scudamore was unable to attend. The Remuneration Committee met on two occasions with all members present, with the exception of Jeremy Scudamore for the December meeting. 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, to appraise the Chairman's performance.

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 other committees, details of which are set out below.

During the year, the board undertook a formal evaluation of its own performance, processes, committees, composition, skills and director induction, facilitated by external consultants. It is intended that this evaluation will be reviewed and updated by the board each year. The Group has a commitment to training and all directors are encouraged to attend suitable training courses. A full, formal induction programme is arranged for all new directors, tailored to their specific requirements, the aim of which is to introduce them to key executives across the business and to enhance their knowledge and understanding of the Group and its activities.

Major shareholders are encouraged to meet and talk to the Chairman, the senior independent director and other non-executive directors at any time. The Chairman and the senior independent director both had dialogue with major shareholders during the year.

The board has adopted guidelines for individual directors to obtain independent professional advice at the Group's expense in appropriate circumstances and all members of the board have access to the advice of the Company Secretary.

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 Combined Code and Nasdaq. 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 and in connection with the acquisition of Artisan Components, Inc. In other 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 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, John Scarisbrick, Jeremy Scudamore and Philip Rowley, who joined the committee on his appointment as a director on 4 January 2005. Peter Cawdron is the financial expert as defined in the Sarbanes Oxley Act 2002 and Philip Rowley is also qualified to fulfill this role. The committee met on four occasions during 2004, once before the release of the preliminary announcement of the 2003 results to review the results and audit findings, once to review the half-year interim results, once in connection with the Artisan acquisition and once before the year end to discuss the scope and planning of the audit of the 2004 results. All members were present at each meeting, with the exception of Doug Dunn for the January meeting, and Jeremy Scudamore for the July and November 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 external 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 27.

Nomination committee

The nomination committee leads the process for board appointments and makes recommendations to the board in relation to new appointments of executive and non-executive directors and on board composition and balance. It is chaired by Sir Robin Saxby, and the other members are Peter Cawdron, Doug Dunn, John Scarisbrick and Lucio Lanza, who joined the committee on his appointment as a director on 23 December 2004. The nomination committee met on two occasions with all members present, with the exception of Doug Dunn for the January meeting. The Committee considers the roles and capabilities required for each new appointment, based on an evaluation of the skills and experience of the existing directors. In relation to the appointments of Jeremy Scudamore and Philip Rowley, the services of external search consultancies 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.

The Company appointed a risk review committee in 2003 consisting of the Chief Technology Officer, the Chief Financial Officer, the Financial Controller and the Company Secretary. The committee receives and reviews quarterly reports from business unit managers and corporate functions and its findings are considered and challenged by the executive committee. The committee 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 committee reports formally to the executive committee once a year and, in turn, the executive committee reports to the board once a year.

The Company appointed a disclosure committee in 2003, 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 Combined Code, the audit committee has considered whether it would be appropriate for the Group to have its own financial internal audit function and has concluded that, taking account of its relatively small number of employees and a high degree of centralisation in the way the business is run, this is not appropriate at present. The Committee has confirmed this view to the board. The Group 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 pages 23 to 24 of this report and also on the Group's website www.arm.com.

The board codified various existing policies into a Code of Business Conduct and Ethics, which was adopted in 2004 and is available on the Group's website.

As a company whose primary business is the licensing of 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 IP. 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 recognises 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 2004. 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.

Energy usage and resource consumption data is published in the Group's corporate social responsibility report on its website.

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 2004 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 and part of the Group's website is dedicated to providing accurate and timely information for all investors including comprehensive information about the business, its Partners and products, including all press releases. 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. Members of the board, including some of the non-executive directors attend the annual analysts' day and develop an understanding of the views of major shareholders through any direct contact that may be initiated by shareholders or through analysts' and brokers' briefings and feedback from the Group's financial PR advisers who obtain feedback from analysts and brokers following investor roadshows. During 2004, the Chairman had meetings with major shareholders to discuss governance and strategy, particularly in relation to the acquisition of Artisan Components, Inc., and communicated the views of such shareholders to the board. All shareholders may register to receive the Group's press releases via the internet.

The board actively encourages participation at the Annual General Meeting, scheduled for 25 April 2005, 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

ARM considers itself to be a good corporate citizen. The Group strives to reduce the impact it makes on the environment and to increase its connections with the communities in which it operates. We also work hard to connect and considerable efforts are made to communicate effectively with the Group's shareholders, Partners, suppliers and employees.

The Group is a corporate member of the Institute of Business Ethics (IBE) and was one of the first members of the 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. ARM's commitment to the charter includes being verified against a 62-point charter standard each year 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 2004, the Group successfully retained its membership. In addition, ARM is listed on the FTSE4Good Index, is a member of Business in the Community, and takes part in its Business in the Environment Index and Corporate Responsibility Index each year.

The environment

The Group's business focuses on designing IP which enables devices to use less power and, as a result, to be more environmentally friendly. Its activities do not produce harmful waste or emissions and the Ethical Investment Research Service (EIRIS) grades ARM as an environmentally "low impact" business. Nevertheless, environmental performance is monitored to enable targets to be set for reducing paper usage (and increasing the amount recycled) and controlling water consumption. 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. There are recycling bins for aluminium cans in the majority of the Group's offices, and air conditioning systems run on less environmentally damaging refrigerants. The supply of company cars is discouraged and in a group of approximately 1,200 people, there are less than 30 company cars. There is a sustainable transport team within the business looking at ways in which impact on the environment can be reduced. Initiatives introduced so far include encouraging employees to cycle to work through the provision of improved facilities at the Group's offices, or to share car journeys, or use public transport. Business travel is measured, and ways in which travel can be reduced while still maintaining our very effective partnership network, are under constant review, particularly through the provision of video conferencing equipment. The Group will work closely with the British Safety Council in 2005 to establish ways to formalise our environmental objectives and performance.

Connecting with local communities

The Group aims to be a good corporate citizen of the communities in which it operates and supports local initiatives and fundraising. In the UK, the focus has been 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 providing employees' time and skills. ARM also connects with the local business community and is a founding member of The Learning Collaboration (TLC) within the Cambridge business community in the UK. The TLC enables member companies to pool resources to collaborate to learn, improving the quality, availability and value of training and related services.

Supporting education. ARM's support for education stretches from funding an information technology centre at a UK junior school, to working on specific projects with students at the Judge Institute, Cambridge University's business school. The Group has helped four schools near its Cambridge, UK offices and one near its Maidenhead, UK office to achieve specialist school status; the Group supports the Engineering Education Scheme, Young Engineers and contributes to the funding to train the UK team for the International Maths Olympics. ARM's University Programme engages universities worldwide, designing course material, providing technical seminars, donating equipment and software and offering assistance directly to students. ARM has worked with a number of engineering schools internationally, including Seoul National University, Carnegie-Mellon (U.S.), Southeast University (China), and the National Institute of Technology Karnataka (India). In addition, the Group has relationships with a number of UK universities. The Chairman, for example, is a visiting professor at Liverpool and the Group has worked with Loughborough to design a degree course which is based on the ARM architecture.

Supporting good causes. ARM encourages employees to support their local communities. Some are school governors, some help children improve their reading skills, others support charities. Employees at the Group's Austin, Texas, office have, for example, helped with blood drives and have also collected food and toys for underprivileged families. The Group "doubles the efforts" of employees who raise money for approved charities by matching the funds they raise (with the exception of political donations or other non-approved causes). Charities for cancer research, to benefit needy children, to support sufferers of multiple sclerosis, mental illness and Parkinson's disease have been some of the beneficiaries of this scheme. In 2004 a payroll giving scheme was introduced for employees in the UK to enable them to take advantage of UK tax incentives on charitable giving.

The Prince's Trust. In 2004 ARM became a sponsor of the Prince's Trust Technology Leadership Group and has participated in events targeted at widening the knowledge and understanding of technology and contributed expertise to the technology networking events. A team of five employees from ARM successfully completed the Prince's Trust Sahara Challenge raising £12,500 for the Trust.

Connecting with employees

ARM's aim is to attract and retain the best people available by being a good and ethical employer. The skills, knowledge and motivation of employees are crucial to ARM's success. The Group promotes and supports individuals and teams through on-the-job and formal training, coaching and mentoring. Every effort is made to keep employees well informed about the Company and matters that affect them. This is done through both formal and informal communications methods across all offices worldwide. The Group also carries out a regular, comprehensive, global opinion survey to monitor employee views and to provide valuable input on how the Company operates. The 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.

Equal opportunities. The Group needs highly-qualified staff and does 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, their needs and abilities are assessed with a view to them continuing in their current role. If this is impossible, every effort is made to offer them alternative employment.

Benefits. Employees receive benefits including private medical/ healthcare; health, travel and life insurance; pensions/401k plan; sabbaticals; flexible working; stock options and a Save As You Earn share scheme. The Group supports family friendly initiatives and offers child care vouchers for UK tax payers. Flexible working arrangements are available for all employees, regardless of whether they have children. Understanding and acceptance of national and cultural diversity is encouraged by giving employees the opportunity to work in offices other than in their home country.

Accessibility

The Group endeavours to provide access to all whether 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. ARM measures and analyses all accidents and "near misses" (there has been only one RIDDOR reportable accident in the Company's history) and by monitoring patterns or trends potential problems can be identified and avoided. The Group is verified by GoodCorporation each year to ensure that its health and safety requirements are met and in addition its UK offices are audited by the British Safety Council. In the UK, there is a health and safety committee and each office has fire wardens and first aiders. Overseas offices have the health and safety cover required by local legislation. Health and safety is high on the agenda and there has been an increase in the amount of communication with employees on occupational health issues and other health and safety issues through different mediums such as intranet pages and company-wide magazine articles. During 2004 further health and safety training has been provided to line managers to assist in the development of a safety culture within the organisation.

The directors present their annual report and audited financial statements for the year ended 31 December 2004.

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 five offices in the US and offices in Shanghai and Beijing PR China; Tokyo, Japan; Seoul, South Korea; Taipei, Taiwan; Kfar Saba, Israel; Paris, France; Munich, Germany and Bangalore, India. Design offices are based in Cambridge, Maidenhead, Sheffield, and Blackburn, UK; Sophia Antipolis, France; Leuven, Belgium; Aachen, Germany; Austin, Texas and Sunnyvale, California in the US and Bangalore, India. More information about the business is set out in the Chairman's statement on pages 4 to 5, the Chief Executive Officer's review on pages 6 to 13, and the operating and financial review on pages 14 to 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 August 2004, the Group acquired Axys Design Automation, Inc., which provides integrated processor and system modelling and simulation solutions. In December 2004 the Group acquired Artisan Components, Inc. (now known as ARM Physical IP, Inc.) which provides physical IP components for the design and manufacture of integrated circuits.

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 final dividend in respect of the year to 31 December 2004 of 0.42 pence per share which, subject to approval at the Annual General Meeting on 25 April 2005, will be paid on 6 May 2005 to shareholders on the register at 1 April 2005. This final dividend, combined with the interim dividend of 0.28 pence per share paid during the year, makes a total of 0.7 pence per share for the year (2003: 0.6 pence).

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 2005 include the development of further low power, high performance engines for both data and control applications, such as the OptimoDE technology and ARM cores based on symmetric multiprocessor and superscalar technology. In addition, improved security is being developed through the TrustZone and SecurJC™ technologies.

The Group incurred R&D costs of £50.1 million in 2004, compared with £48.1 million in 2003, which have been charged to the profit and loss account.

Donations

During the year the Group made donations for charitable purposes of £33,327 (2003: £42,486). The total amounts given for each such purpose were:

Local Cambridge charities	£7,919
Promotion of education	£11,979
Wider understanding of science, maths and information technology	£9,180
Medical research	£3,478
Relief of poverty	£771

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 continued to consider the impact that implementing IFRS in 2005 will have on its financial statements and reporting functions. The project is ongoing and is well progressed, and the Group continually monitors the new announcements being made by the IASB. The Group has performed analyses of the impact of the current standards, and has accordingly begun to maintain its internal financial reporting in 2005 in accordance with IFRS. The key areas which will affect the financial statements and accounting policies are derivatives and financial instruments, revenue recognition, intangibles, share-based payments, acquisition accounting and accounting for R&D costs. The first results to be announced in accordance with IFRS will be the Group's interim statement for the six months to 30 June 2005.

Directors in the year

The following served as directors of the Company during the year ended 31 December 2004:

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)
Mark Templeton (General Manager, Physical IP division; appointed 23 December 2004)
Peter Cawdron (independent non-executive, Senior Independent Director, financial expert)
Doug Dunn OBE (independent non-executive)
Lucio Lanza (non-executive; appointed 23 December 2004)
John Scarisbrick (independent non-executive)
Jeremy Scudamore (independent non-executive; appointed 26 April 2004)
Lawrence Tesler (independent non-executive; resigned 26 April 2004)

Election and re-election of directors
Jeremy Scudamore, Philip Rowley and Simon Segars were each appointed to the board since the Annual General Meeting in 2004. In accordance with Article 83 of the Group's Articles of Association, they are standing for election at the Annual General Meeting.

In accordance with the Article 79 of the Group's Articles of Association Sir Robin Saxby, Mike Muller, Tudor Brown, Doug Dunn, John Scarisbrick and Tim Score will retire by rotation at the Company's Annual General Meeting (AGM) and will seek re-election at that meeting. (See pages 18 to 19 for the directors' biographies.)

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 27.

Substantial shareholdings
The directors are aware of the following substantial interests in the issued share capital of the Company as at 16 February 2005:

	Percentage of issued ordinary share capital
Capital Group Companies	10.2%
Fidelity Investments	5.3%
Legal and General Investment Management	3.7%
Janus Capital Corporation	3.6%
American Century Investments	3.3%
Threadneedle Asset Management	3.1%

Save for the above, the Company has not been notified, as at 16 February 2005, 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 IP 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 an 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 2004 were equivalent to 26 days' purchases for the Group (2003: 23 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 25 April 2005 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.

A separate notice of AGM and proxy card will be sent to all shareholders.

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 options and awards, 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 Jeremy Scudamore are members. The committee met three times during 2004 and all meetings were attended by all the committee members, with the exception of the July and December meetings when Jeremy Scudamore 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 Bill Parsons, the Executive Vice President, Human Resources, in the furtherance of its duties and makes use of such advice. During 2004, Linklaters, Watson Wyatt, Deloitte & Touche and the Executive Vice President, Human Resources, have provided advice or services to the committee. Linklaters provided legal services and Watson Wyatt provided pension advice to the Group during this period. The Chairman, the Chief Executive Officer and the 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 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 and, to this end, operates a policy of paying base salaries which are in line with the market median, as part of a total remuneration package which is upper quartile. The committee believes that this is justified, recognising that more than 50% of total remuneration is performance-related. The committee obtains information about the external market from various surveys, including the Watson Wyatt High Technology and Executive Reward Surveys and the Deloitte & Touche Executive Directors Remuneration Survey.

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 may 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 equivalent in value to 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 revenue and profit targets set by the remuneration committee, which are directly related to the Group's financial results and ensure that the Group's short-term financial goals are met. Full bonuses are payable to executive directors in respect of performance during 2004.

For the 2005 operation of the bonus plan, the targets set by the remuneration committee are for growth in dollar revenues between an agreed range with the proviso that no bonus will be payable unless earnings per share exceed a defined target. If these targets are achieved, bonuses will be payable on a linear basis between the minimum and the maximum of the agreed range. Any over achievement of the stretching revenue target will result in the percentage out-performance being applied to the bonus, for example if the revenue target is exceeded by 10% the bonus will increase by 5%. Annual bonuses can be doubled under the deferred bonus plan if payment is deferred for three years, although there are no outstanding elections to do so. Details of the deferred bonus plan are set out on page 33.

The Group operates a number of share option plans and employees generally receive a number of share options according to their grade and performance. 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 Savings-Related Share Option Scheme and the Savings-Related Share Option Plan 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 where performance conditions based on real EPS apply to drive long-term profitability. 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. 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 in 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 in 2004 and 2005 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.

The performance conditions applicable to the Long Term Incentive Plan are described in more detail below and are based on total shareholder return (TSR), rather than EPS, providing the link to performance against an appropriate peer group.

These performance conditions were selected having regard to the position of the Group within its sector and the nature of the companies against which it competes to attract and retain high-calibre employees. The Committee believes that the performance conditions represent the correct balance between being motivational and challenging.

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. For the UK-based directors, 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. For Mark Templeton (who is based in the US) the rate of Group contribution is 6% of his basic salary.

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
Mark Templeton	18 November 2004

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 2004, the Chairmen of the audit and remuneration committees each received a total fee of £29,000 per annum and the other non-executive directors each received a total fee of £27,000 per annum. These fees were arrived at by reference to fees paid by other companies of similar size and complexity, and reflected the amount of time non-executive directors were expected to devote to the Group's activities during the year, which is around 10 to 15 working days a year. The 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. The options held by Lucio Lanza were granted during his service with Artisan and were rolled over into options over ARM shares under the terms of the acquisition.

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 1999 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 -87% over this period compared with -67% for the FTSE Global Technology Index for the same period.

ARM share price performance against the 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 and, therefore, 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 2004 Number**	31 December 2003 Number
Sir Robin Saxby	**21,363,060**	22,363,060
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
Jeremy Scudamore	**55,000**	–
Mark Templeton	**10,535,552**	–
Lucio Lanza	**1,277,291**	–

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 713,034 ordinary shares respectively at 31 December 2004, and 5,000,000 and 721,080 shares respectively at 31 December 2003. There have been no 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 2004 Number	Granted Number	Exercised Number	**As at 31 December 2004 Number**	Exercise price £	Earliest date of exercise	Expiry date
Sir Robin Saxby	140,000	–	–	**140,000**	1.224	11/03/02	10/03/06**
	25,000	–	–	**25,000**	6.155	22/05/01	21/05/07†
	165,000	–	–	**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***
	–	400,000	–	**400,000**	1.25	30/01/07	30/01/11***
	1,241,343	400,000	–	**1,641,343**			
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***
	–	320,000	–	**320,000**	1.25	30/01/07	30/01/11***
	984,038	320,000	–	**1,304,038**			

Director	As at 1 January 2004 Number	Granted Number	Exercised Number	**As at 31 December 2004 Number**	Exercise price £	Earliest date of exercise	Expiry date
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	14/05/02	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***
	–	320,000	–	**320,000**	1.25	30/01/07	30/01/11***
	971,428	320,000	–	**1,291,428**			
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	14/05/02	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***
	–	288,000	–	**288,000**	1.25	30/01/07	30/01/11***
	967,779	288,000	–	**1,255,779**			
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***
	–	288,000	–	**288,000**	1.25	30/01/07	30/01/11***
	954,943	288,000	–	**1,242,943**			
Mark Templeton	–	449,561	–	**449,561**	0.39	18/04/01	17/04/10
	–	1,078,947	–	**1,078,947**	0.25	05/11/02	04/11/11
	–	449,561	–	**449,561**	0.47	15/08/04	22/10/13
	–	170,832	–	**170,832**	0.70	23/12/04	19/08/14
	–	2,148,901	–	**2,148,901**			
Lucio Lanza	–	89,912	–	**89,912**	0.57	17/03/00	16/02/10
	–	7,498	–	**7,498**	0.22	16/05/01	15/04/11
	–	26,236	–	**26,236**	0.44	07/03/02	06/02/12
	–	588,134	–	**588,134**	0.50	09/05/03	08/04/13
	–	577,615	–	**577,615**	0.66	11/04/04	10/03/14
	–	411,421	–	**411,421**	0.55	11/04/04	08/04/14
	–	1,700,816	–	**1,700,816**			

* 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.

Details of the performance conditions and implications on the vesting of options is noted in the remuneration policy section above.

On 4 February 2005, discretionary share options were granted to the following executive directors: Warren East 592,417; Tim Score 473,934; Tudor Brown 436,019; Mark Templeton 498,774, Mike Muller 398,104; Mike Inglis 379,147; and Simon Segars 341,232. The exercise price is 105.5 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 2004 Number	Granted Number	Lapsed Number	**As at 31 December 2004 Number**	Exercise price £	Earliest date of exercise	Expiry date
Sir Robin Saxby	15,771	–	–	**15,771**	0.5865	01/08/06	31/12/06
Warren East	15,771	–	–	**15,771**	0.5865	01/08/06	31/12/06
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	15,771	–	–	**15,771**	0.5865	01/08/06	31/12/06

Long Term Incentive Plan

A Long Term Incentive Plan was approved by shareholders at the 2003 Annual General Meeting. The 2004 conditional awards were made on 3 November 2004. Conditional share awards held by directors are as follows:

Director	Performance period ending 31 December	Award date	Market price at date of award £	As at 1 January 2004 Number	Conditional award Number	**As at 31 December 2004 Number**	Vesting date
Warren East	2005	25 July 2003	0.805	248,447	–	**248,447**	January 2006
	2006	3 November 2004	1.005	–	248,756	**248,756**	January 2007
				248,447	248,756	**497,203**	
Tim Score	2005	25 July 2003	0.805	211,180	–	**211,180**	January 2006
	2006	3 November 2004	1.005	–	199,005	**199,005**	January 2007
				211,180	199,005	**410,185**	
Tudor Brown	2005	25 July 2003	0.805	198,758	–	**198,758**	January 2006
	2006	3 November 2004	1.005	–	199,005	**199,005**	January 2007
				198,758	199,005	**397,763**	
Mike Muller	2005	25 July 2003	0.805	198,758	–	**198,758**	January 2006
	2006	3 November 2004	1.005	–	179,104	**179,104**	January 2007
				198,758	179,104	**377,862**	
Mike Inglis	2005	25 July 2003	0.805	198,758	–	**198,758**	January 2006
	2006	3 November 2004	1.005	–	179,104	**179,104**	January 2007
				198,758	179,104	**377,862**	

Conditional awards will vest to the extent that the performance criteria are satisfied over a three-year performance period from 1 January of the year of award, and no re-testing thereafter is possible. 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 2004 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 2004 was 110.5 pence. The closing mid-price ranged from 79 pence to 144.75 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. At 31 December 2004, the bonus payable to him was £25,360 representing an increase of 100% plus interest. This is included within his emoluments disclosed below. 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, with the exception of Mark Templeton who was paid through Artisan Components Inc., whilst the non-executive directors were paid through ARM Holdings plc, with the exception of Lucio Lanza who was paid through Artisan Components Inc., and were as follows:

Director	Fees £	Basic salary £	Benefits** £	Bonus payments £	Subtotal £	Pension contributions £	**Total 2004 £**	Subtotal 2003 £	Pension contributions 2003 £	Total 2003 £
Executive										
Sir Robin Saxby	–	125,000	11,821	62,500	199,321	25,313	**224,634**	211,710	24,638	236,348
Warren East	–	250,000	11,821	139,686***	401,507	10,125	**411,632**	211,710	9,855	221,565
Tim Score	–	200,000	11,841	100,000	311,841	10,125	**321,966**	180,728	9,855	190,583
Tudor Brown	–	200,000	11,821	100,000	311,821	10,125	**321,946**	171,710	9,855	181,565
Mike Muller	–	180,000	11,821	90,000	281,821	10,125	**291,946**	171,710	9,855	181,565
Mike Inglis	–	180,000	11,821	90,000	281,821	10,125	**291,946**	171,710	9,855	181,565
Mark Templeton*	–	1,700	112	–	1,812	–	**1,812**	–	–	–
Total	–	1,136,700	71,058	582,186	1,789,944	75,938	**1,865,882**	1,119,278	73,913	1,193,191
Non-executive										
Peter Cawdron	29,000	–	–	–	29,000	–	**29,000**	24,000	–	24,000
Doug Dunn	29,000	–	–	–	29,000	–	**29,000**	24,000	–	24,000
John Scarisbrick	27,000	–	–	–	27,000	–	**27,000**	24,000	–	24,000
Jeremy Scudamore*	18,517	–	–	–	18,517	–	**18,517**	–	–	–
Lawrence Tesler*	9,000	–	–	–	9,000	–	**9,000**	24,000	–	24,000
Lucio Lanza*	–	–	–	–	–	–	**–**	–	–	–
Total	112,517	–	–	–	112,517	–	**112,517**	96,000	–	96,000
Total	112,517	1,136,700	71,058	582,186	1,902,461	75,938	**1,978,399**	1,215,278	73,913	1,289,191

* For Jeremy Scudamore, fees are shown from the date of his appointment on 26 April 2004, for Mark Templeton and Lucio Lanza from 23 December 2004. For Lawrence Tesler, fees are shown up to his date of resignation on 26 April 2004.

** All the executive directors receive family healthcare and annual travel insurance as part of their benefits in kind. In addition, Tim Score has the use of a company car, and Robin Saxby, Warren East, Tudor Brown, Mike Muller and Mike Inglis receive a car and petrol allowance.

*** The bonus for Warren East includes £14,686 that is payable to him under the deferred bonus plan described above.

Mike Inglis is a non-executive director of Superscape Group plc. 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 pages 49 to 50. In this capacity, Mike Inglis received remuneration totalling £15,000 up to 31 December 2004 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.

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 36 to 63 which have been prepared under the historical cost convention and the accounting policies set out on pages 40 to 42. 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 of operations, the operating and financial review, directors and advisers, 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 nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's or Company's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Group and the Company at 31 December 2004 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
4 March 2005

Consolidated profit and loss account/UK GAAP
For the year ended 31 December 2004

	Notes	2004 £000	2003 £000
Turnover	2	**152,897**	128,070
Cost of sales	3	**(11,799)**	(11,022)
Gross profit	3	**141,098**	117,048
Operating expenses			
Research and development	3	**(50,133)**	(48,131)
Sales and marketing	3	**(23,899)**	(23,007)
Administrative expenses	3	**(31,845)**	(27,471)
Total operating expenses		**(105,877)**	(98,609)
Operating profit	2	**35,221**	18,439
Interest receivable and similar income		**6,944**	4,801
Profit on ordinary activities before taxation	2, 6	**42,165**	23,240
Tax on profit on ordinary activities	7	**(10,153)**	(7,977)
Profit on ordinary activities after taxation		**32,012**	15,263
Equity minority interest		**–**	(105)
Profit for the financial year	8	**32,012**	15,158
Dividends paid and proposed	9	**(8,542)**	(6,106)
Retained profit for the financial year	21	**23,470**	9,052
Earnings per 0.05 pence ordinary share			
Basic	10	**3.1p**	1.5p
Diluted	10	**3.1p**	1.5p

All activities relate to continuing activities. The acquisition of Artisan Components Inc. was completed on 23 December 2004, and, since trading results between 23 December 2004 and 31 December 2004 are not material, no separate disclosure on the face of the profit and loss account has been made. In August 2004, the Group acquired Axys Design Automation Inc. The post-acquisition results of Axys are not material and so have not been seperately disclosed on the face of the profit and loss account.

Statement of Group total recognised gains and losses/UK GAAP

	Notes	2004 £000	2003 £000
Profit for the financial year		**32,012**	15,158
Foreign exchange difference on consolidation	21, 22	**(410)**	(1,425)
Total recognised gains for the year and since last annual report		**31,602**	13,733

Consolidated balance sheet/UK GAAP

As at 31 December 2004

	Notes	2004 £000	2003 £000
Fixed assets			
Intangible assets	11	**462,408**	7,547
Tangible assets	12	**14,117**	16,583
Investments	13, 18	**10,751**	4,759
		487,276	28,889
Current assets			
Stocks	14	**897**	931
Debtors (including £6,385,000 (2003: £nil) long-term deferred tax asset)	15	**71,627**	29,829
Short-term investments	18	**59,186**	129,663
Cash at bank and in hand	18	**78,193**	30,123
		209,903	190,546
Creditors: amounts falling due within one year	16	**(76,892)**	(38,937)
Net current assets		**133,011**	151,609
Total assets less current liabilities		**620,287**	180,498
Creditors: amounts falling due after one year	17	**(1,732)**	–
Provisions for liabilities and charges	19	**(27)**	(63)
Net assets	2	**618,528**	180,435
Capital and reserves			
Called-up share capital	20	**675**	512
Share premium account	21	**82,447**	81,137
Merger reserve	21	**351,579**	–
Foreign exchange reserve	21	**(2,498)**	(2,088)
Other reserve	21	**61,474**	–
Profit and loss account	21	**124,851**	100,874
Equity shareholders' funds	22	**618,528**	180,435

The financial statements on pages 36 to 63 were approved by the board of directors on 4 March 2005 and were signed on its behalf by:

Sir Robin Saxby Director

Company balance sheet/UK GAAP
As at 31 December 2004

	Notes	2004 £000	2003 £000
Fixed assets			
Investments	13	**195,043**	–
Current assets			
Debtors	15	**82**	44,637
Short-term investments		**13,391**	50,223
Cash at bank and in hand		**4,226**	50
		17,699	94,910
Creditors: amounts falling due within one year	16	**(52,536)**	(6,400)
Net current (liabilities)/assets		**(34,837)**	88,510
Total assets less current liabilities		**160,206**	88,510
Net assets		**160,206**	88,510
Capital and reserves			
Called-up share capital	20	**675**	512
Share premium account	21	**82,447**	81,137
Other reserve	21	**61,474**	–
Profit and loss account	21	**15,610**	6,861
Equity shareholders' funds		**160,206**	88,510

The financial statements on pages 36 to 63 were approved by the board of directors on 4 March 2005 and were signed on its behalf by:

Sir Robin Saxby Director

Consolidated cash flow statement/UK GAAP
For the year ended 31 December 2004

	Notes	2004 £000	2003 £000
Net cash inflow from operating activities	24	**50,753**	43,740
Returns on investments and servicing of finance			
Interest received		**7,233**	4,930
Net cash inflow from returns on investments and servicing of finance		**7,233**	4,930
Taxation			
Withholding tax paid		**(4,295)**	(2,940)
UK corporation tax paid		**(6,252)**	(6,161)
Overseas tax paid		**(1,054)**	(824)
Tax paid		**(11,601)**	(9,925)
Capital expenditure and financial investment			
Purchase of fixed asset investments		**(50)**	(1,152)
Purchase of tangible fixed assets		**(5,330)**	(3,311)
Sale of tangible fixed assets		**23**	34
Purchase of intangible fixed assets		**(65)**	(655)
Net cash outflow for capital expenditure and financial investment		**(5,422)**	(5,084)
Acquisitions			
Purchase of subsidiary undertakings	23	**(133,065)**	(3,413)
Net cash acquired with subsidiary undertakings		**44,748**	23
Net cash outflow for acquisitions	27	**(88,317)**	(3,390)
Equity dividends paid		**(8,975)**	–
Net cash (outflow)/inflow before management of liquid resources and financing		**(56,329)**	30,271
Management of liquid resources			
Decrease/(increase) in short-term investments	26	**102,965**	(3,650)
Financing			
Issue of shares	20	**1,311**	255
Proceeds received by QUEST on allocation of own shares held		**2**	263
Net cash inflow from financing		**1,313**	518
Increase in cash	26	**47,949**	27,139

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 consistently applied and reviewed by the board of directors in accordance with Financial Reporting Standard (FRS) 18, "Accounting policies", is set out below.

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

Basis of consolidation The consolidated profit and loss account and balance sheet include the financial statements of the Company and its subsidiary undertakings made up to 31 December 2004. 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. In determining the fair value of consideration, the fair value of equity is the market value of the equity at the date of completion, the fair value of share options assumed is calculated using the Black Scholes valuation model, and the fair value of contingent consideration is based upon whether the directors believe any performance conditions will be met and thus whether any further consideration will become payable.

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.

Where a technology agreement confers both retrospective and prospective rights, each element is valued based on a discounted cash flow analysis. The retrospective element is charged to the profit and loss account immediately, whilst the prospective element is capitalised.

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. If circumstances change such that the market value of the investment exceeds the carrying value, the impairment charged is reversed.

Investments in subsidiaries Investments in subsidiaries are initially recorded at cost. Where an acquisition satisfies the provisions of sections 131 to 134 of the Companies Act 1985 for merger relief, the investment is stated at the nominal value of shares issued plus the fair value of any other consideration.

Short- and long-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. Money market instruments are included within short-term investments at the lower of cost and net realisable value. Deposits and marketable securities with maturity more than one year from the balance sheet date are shown as long-term marketable securities within fixed asset investments and are shown at cost less any provision for impairment.

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. Costs that are directly attributable to the development of new business application software and which are incurred during the prior period to the date that the software is placed into operational use, are capitalised. External and internal costs are capitalised to the extent they enhance the future economic benefits of the business. 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 to five 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 even if payments are not made on such a basis.

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.

1 Principal accounting policies continued

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.

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.

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. If the amount of revenue recognised exceeds the amounts invoiced to customers, the excess amount is recorded as amounts recoverable on contracts within debtors.

Where agreements involve multiple elements, the entire fee from such arrangements has been allocated to each of the individual elements based on each element's fair value. Vendor-specific objective evidence (VSOE) of fair value is determined 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) (PCS) 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. Revenue related to PCS is recognised based on VSOE, which is determined with reference to contractual renewal rates, or, if none are specified, by reference to the rates actually charged on renewal PCS arrangements for the same level of support and for the same or similar technologies. Revenue for PCS 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 PCS 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.

1 Principal accounting policies continued

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 balance sheet date. Profit and loss accounts of overseas subsidiary undertakings are translated at the monthly exchange rates during the year. Differences on exchange arising from the retranslation of the opening net investment in subsidiary companies are taken to reserves and reported in the statement of Group total recognised gains and losses.

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

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

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

Share schemes The Group's Employee Share Ownership Plan (ESOP) and Qualifying Employee Share Ownership Trust (QUEST) are separately administered trusts which are funded by loans (the ESOP) and loans and gifts (the QUEST) from the Group, and the assets of which comprise shares in the Company. In accordance with UITF 38 "Accounting for ESOP Trusts", 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 21).

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. A similar charge arises on the difference between the market value of ARM's shares and the exercise price of certain options issued as part of the consideration for a business acquisition. 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, "National Insurance contributions on share option gains", 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 had only one class of business during 2004. Following the acquisition of Artisan Components Inc. the directors are considering whether the business is going to be re-organised and whether different reportable segments will be formed. The Group's operations by geographic area are as follows:

Turnover by destination

	2004 £000	2003 £000
Europe	**23,837**	23,118
United States	**77,457**	65,402
Asia Pacific	**51,603**	39,550
	152,897	128,070

Turnover by origin

	2004			2003		
	Total sales £000	Inter-segment sales £000	External sales £000	Total sales £000	Inter-segment sales £000	External sales £000
Europe	**152,915**	**(10,941)**	**141,974**	127,297	(8,412)	118,885
United States	**24,861**	**(18,477)**	**6,384**	22,702	(17,809)	4,893
Asia Pacific	**7,564**	**(3,025)**	**4,539**	7,995	(3,703)	4,292
	185,340	**(32,443)**	**152,897**	157,994	(29,924)	128,070

Profit before taxation, by origin

	2004			2003		
	Operating profit £000	Interest £000	Profit before tax £000	Operating profit £000	Interest £000	Profit before tax £000
Europe	**32,262**	**6,802**	**39,064**	14,621	4,591	19,212
United States	**720**	**63**	**783**	1,373	9	1,382
Asia Pacific	**2,239**	**79**	**2,318**	2,445	201	2,646
	35,221	**6,944**	**42,165**	18,439	4,801	23,240

Net assets

	2004 £000	2003 £000
Europe	**62,224**	169,305
United States	**552,748**	7,267
Asia Pacific	**3,556**	3,863
	618,528	180,435

The above analyses of turnover, profit before taxation and net assets in 2004 include contributions from the Group's acquisitions of Axys Design Automation Inc. and Artisan Components Inc. as follows:

Axys: turnover by origin – United States £596,000; turnover by destination – Asia Pacific £238,000, Europe £43,000, United States £315,000. No indication can be given of the profit before tax or net assets of Axys since acquisition as the business and assets were integrated into existing Group operations shortly after purchase.

Artisan: turnover by origin – United States £195,000; turnover by destination – Asia Pacific £195,000; loss before tax, by origin – United States £256,000; net assets/(liabilities) – United States £95,621,000, Asia Pacific (£135,000), Europe (£64,000).

The following table shows the split of net assets of the Group between those of the legacy ARM business and those of Artisan (the Physical IP division).

	2004 including goodwill £000	2004 excluding goodwill £000	2003 including goodwill £000	2003 excluding goodwill £000
Legacy ARM (Cores)	**73,034**	**64,392**	180,435	178,344
Physical IP	**545,494**	**94,723**	–	–
	618,528	**159,115**	180,435	178,344

3 Cost of sales, gross profit and operating expenses

In relation to the acquired entity, Artisan Components Inc., the total figures for continuing operations in 2004 include the following amounts: cost of sales: £nil; gross profit: £195,000; research and development: £202,000; sales and marketing: £177,000; administrative expenses: £126,000. In relation to the acquired entity, Axys Design Automation Inc., no indication can be given of the impact on operating costs as the business and assets were integrated into those of the Group shortly after purchase and it is now not possible to separately identify those costs.

4 Directors' emoluments

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

	2004 £	2003 £
Aggregate emoluments in respect of qualifying services	**1,902,461**	1,215,278
Aggregate gains made on exercise of share options	**–**	330,000
	1,902,461	1,545,278
Aggregate Group pension contributions to money purchase schemes	**75,938**	73,913
	1,978,399	1,619,191

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

	2004 £	2003 £
Emoluments in respect of qualifying services	**401,507**	211,710
Gains made on exercise of share options	**–**	330,000
	401,507	541,710
Group pension contributions to money purchase schemes	**10,125**	24,638
	411,632	566,348

Detailed disclosures of directors' emoluments are shown on page 33. Details of directors' interests in share options are shown on pages 30 to 32, which form part of these financial statements.

5 Employee information

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

	2004 Number	2003 Number
By activity:		
Research and development	**464**	430
Administration	**106**	96
Sales and marketing	**204**	204
	774	730

	2004 £000	2003 £000
Staff costs (for the above persons):		
Wages and salaries	**42,506**	35,747
Social security costs	**4,077**	3,584
Other pension costs	**2,067**	1,848
	48,650	41,179

Due to a change in pension scheme arrangements within ARM Belgium N.V. effected post-acquisition in 2003, the pension provision in existence at acquisition was released to the profit and loss account in 2003 and the credit of £1,069,000 is not included in the above numbers.

Of the total pension costs above, £12,000 (2003: £47,000) remained unpaid at the year end.

6 Profit on ordinary activities before taxation

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

	2004 £000	2003 £000
Depreciation charge for the year:		
Tangible owned fixed assets	**9,927**	12,908
Amortisation of goodwill	**2,103**	1,299
Amortisation of other intangible assets	**2,621**	3,342
(Write-back)/impairment of fixed asset investments	**(392)**	622
Loss/(profit) on disposal of fixed assets	**20**	(6)
Auditors' remuneration:		
Audit services		
– statutory audit (Company: £5,000 (2003: £5,000))	**314**	166
– audit-related regulatory reporting	**95**	51
Further assurance services		
– royalty audits	**14**	72
– other advisory work	**6**	13
Tax compliance and advisory work	**76**	87
Hire of plant and machinery – operating leases	**8,769**	4,433
Leased buildings – operating leases	**3,858**	3,736

Fees to other major firms of accountants for non-audit services amounted to £509,000 (2003: £260,000).

Included above are fees paid to the Group's auditors in respect of non-audit services in the UK of £46,000 (2003: £64,000).

Fees paid to the auditors disclosed above exclude £1.5 million paid in respect of services received in connection with the acquisition of Artisan Components Inc., in relation to due diligence services, taxation services, in conjunction with their role as reporting accountants and services in conjunction with filings with the SEC. These balances are partly capitalised within goodwill and partly offset against the share premium account.

7 Tax on profit on ordinary activities

	2004 £000	2003 £000
Current		
UK corporation tax at 30% (2003: 30%)	**10,638**	8,162
Overseas corporation tax	**1,142**	1,009
Under/(over) provision in respect of prior years:		
UK corporation tax	**(496)**	72
Overseas corporation tax	**–**	(18)
	11,284	9,225
Deferred		
UK deferred tax – origination and reversal of timing differences	**(1,171)**	(1,622)
Overseas deferred tax – origination and reversal of timing differences	**40**	374
Subtotal	**(1,131)**	(1,248)
	10,153	7,977

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 £1,647,000 (2003: £958,000).

7 Tax on profit on ordinary activities continued

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

	2004 £000	2003 £000
Profit on ordinary activities before taxation	**42,165**	23,240
Taxation charge at UK corporation tax rate of 30%	**12,650**	6,972
Effects of:		
Under/(over) provision in respect of prior years	**(496)**	54
Accelerated capital allowances and other timing differences	**795**	1,638
Permanent differences	**(1,435)**	1,202
Higher average tax rates in overseas countries	**124**	(8)
Losses utilised during the year	**(354)**	(633)
Current tax charge for the year	**11,284**	9,225

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

	Deferred tax asset 2004 £000	Deferred tax asset 2003 £000
At 1 January	**3,585**	1,697
Asset relating to losses acquired with subsidiary undertaking (see note 23)	**16,156**	640
Credited to the profit and loss account	**1,131**	1,248
Foreign exchange	**(40)**	–
At 31 December	**20,832**	3,585

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

	Amount recognised		Amount not recognised	
	2004 £000	2003 £000	2004 £000	2003 £000
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	**5,668**	2,844	**–**	–
Losses carried forward	**13,571**	395	**254**	420
Other	**1,593**	346	**–**	83
	20,832	3,585	**254**	503

Included within the amount recognised for losses carried forward is an amount of £6,385,000 (2003: £nil) that is expected to be charged to the profit and loss account after more than one year.

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 £17,279,000 (2003: £10,546,000).

9 Dividends paid and proposed

	2004 £000	2003 £000
Interim paid of 0.28 pence (2003: nil) per ordinary share	**2,869**	–
Final proposed of 0.42 pence (2003: 0.6 pence) per ordinary share	**5,673**	6,106
	8,542	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 5,713,034 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 2004, 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:

	2004			2003		
	Earnings £000	**Number of shares Thousands**	**Per share amount Pence**	Earnings £000	Number of shares Thousands	Per share amount Pence
Basic EPS						
Profit available to ordinary shareholders	**32,012**	**1,026,890**	**3.1p**	15,158	1,016,484	1.5p
Effect of dilutive securities:						
Options	**–**	**22,179**		–	16,797	
Diluted EPS						
Adjusted earnings	**32,012**	**1,049,069**	**3.1p**	15,158	1,033,281	1.5p

11 Intangible fixed assets

Group	Patents and licences £000	Goodwill £000	Total £000
Cost			
At 1 January 2004	12,900	8,124	21,024
Additions (see note 23)	160	459,863	460,023
Exchange differences	–	(473)	(473)
At 31 December 2004	**13,060**	**467,514**	**480,574**
Aggregate amortisation			
At 1 January 2004	7,444	6,033	13,477
Charge for the year	2,621	2,103	4,724
Exchange differences	–	(35)	(35)
At 31 December 2004	**10,065**	**8,101**	**18,166**
Net book value			
At 31 December 2004	**2,995**	**459,413**	**462,408**
At 31 December 2003	5,456	2,091	7,547

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 cases of Allant Software Corporation and Noral Micrologics Limited and five years in the cases of ARM Korea Limited and ARM Belgium NV. Goodwill arising on the current year's acquisitions of Axys Design Automation Inc. and ARM Physical IP Inc. (formerly known as Artisan Components Inc.) is being written off over five and ten years respectively.

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 2004	190	20,345	44,274	3,202	68,011
Acquired with subsidiary undertakings (see note 23)	–	332	1,587	640	2,559
Additions	–	1,397	3,473	166	5,036
Disposals	–	(551)	(1,130)	(737)	(2,418)
Exchange differences	–	(118)	(126)	(56)	(300)
At 31 December 2004	**190**	**21,405**	**48,078**	**3,215**	**72,888**
Aggregate depreciation					
At 1 January 2004	42	12,515	36,661	2,210	51,428
Charge for the year	8	4,109	5,439	371	9,927
Disposals	–	(532)	(1,125)	(718)	(2,375)
Exchange differences	–	(72)	(94)	(43)	(209)
At 31 December 2004	**50**	**16,020**	**40,881**	**1,820**	**58,771**
Net book value					
At 31 December 2004	**140**	**5,385**	**7,197**	**1,395**	**14,117**
At 31 December 2003	148	7,830	7,613	992	16,583

The Company does not own any tangible fixed assets.

13 Fixed asset investments

Group	Listed investments £000	Long-term marketable securities £000	Other investments £000	Total £000
Cost				
At 1 January 2004	2,652	–	4,168	6,820
Acquired with subsidiary undertakings (see note 23)	–	5,438	–	5,438
Additions	–	–	162	162
Transfer	688	–	(688)	–
At 31 December 2004	**3,340**	**5,438**	**3,642**	**12,420**
Amounts written off				
At 1 January 2004	–	–	2,061	2,061
Reversal of impairment	–	–	(392)	(392)
At 31 December 2004	**–**	**–**	**1,669**	**1,669**
Net book value				
At 31 December 2004	**3,340**	**5,438**	**1,973**	**10,751**
At 31 December 2003	2,652	–	2,107	4,759

Listed investments The Group owns a 12% holding in Superscape Group plc, the cost and market value of which as at 31 December 2004 were £2,652,000 and £8,795,000 respectively (2003: £2,652,000 and £4,139,000 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. In addition, the Group owns a less than 1% holding in CSR plc, a company that develops Bluetooth solutions that listed during the year and was owned prior to that listing. The cost and market value of this investment as at 31 December 2004 were £688,000 (2003: £688,000) and £1,467,000 respectively. There was no readily available market value for CSR plc at 31 December 2003 as the company was an unlisted private company at that time. On flotation, the impairment provision previously booked against this investment was released, as the flotation price exceeded original cost to the Group and the previous carrying value of the investment. Therefore the total market value of listed investments held at 31 December 2004 was £10,262,000 (2003: £4,139,000).

Long-term marketable securities This includes all money market deposits and investments (including US government notes and bonds, corporate notes and bonds and commercial paper) with maturity dates exceeding one year from the balance sheet date.

13 Fixed asset investments continued

Other investments Included in other investments are the Group's 3.2% holding 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. During 2004, the Group acquired a less than 1% holding in Zeevo Inc., a US company providing system-on-chip solutions for Bluetooth and other wireless communication applications, through conversion of trade receivables into equity, and a 2.4% holding in Reciva Limited, an internet radio company based in the UK.

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

Company

The cost and net book value of interests in Group undertakings held by the Company was £195,043,000 at 31 December 2004 and £2 at 31 December 2003. The Company has taken advantage of merger relief and not recorded the premium on the issue of shares for the acquisition of Artisan Components Inc. (now known as ARM Physical IP Inc.) and thus has also not recorded the premium within the value of the investment in the Company balance sheet.

	Investments in subsidiary undertakings £000
Cost and net book value	
At 1 January 2004	–
Additions	195,043
At 31 December 2004	195,043

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 Physical IP Inc.	US	Common $0.001 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. The principal activity of ARM Physical IP Inc. (formerly known as Artisan Components Inc.) is the marketing, research and development of physical intellectual property components for system-on-chip integrated circuits. ARM QUEST Trustees Limited is the trustee company of the Company's QUEST.

The Group holds the following investments in subsidiaries, all held by ARM Limited unless otherwise stated.

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%
Axys Design Automation Inc.	US	Development of integrated processor modelling solutions	100%*
Axys GmbH	Germany	Development of integrated processor modelling solutions	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%
ARM Embedded Solutions Pvt. Ltd.	India	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%
Artisan Components International Limited	Republic of Ireland	Holding company	100%***
Artisan Components San Diego Operations Inc.	US	Development and support of physical IP	100%***
Artisan Components International Delaware LLC	US	Holding company	100%†
Artisan Components Software Pvt. Ltd	India	Development and support of physical IP	100%†
Artisan Components Asia Pacific Pte. Ltd	Singapore	Marketing of physical IP	100%†

* held by ARM Inc.
** held by Axys Design Automation Inc.
*** held by ARM Physical IP Inc.
† held by Artisan Components International Limited

13 Fixed asset investments continued

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	2004 £000	2003 £000
Finished goods	**897**	931

There is no material difference between the balance sheet value of stock and its replacement cost.

The Company had no stocks at 31 December 2004 and 2003.

15 Debtors

	Group		Company	
	2004 £000	2003 £000	**2004 £000**	2003 £000
Trade debtors	**28,451**	17,320	**–**	–
Amounts recoverable on contracts	**5,896**	–	**–**	–
Amounts owed by Group undertakings	**–**	–	**–**	44,430
Other debtors	**4,487**	1,580	**–**	–
Deferred tax (see note 7)	**20,832**	3,585	**–**	–
Prepayments and accrued income	**11,961**	7,344	**82**	207
	71,627	29,829	**82**	44,637

All amounts above fall due within one year except that included within deferred tax is £6,385,000 (2003: £nil) falling due after more than one year and within prepayments and accrued income is £484,000 (2003: £1,036,000) falling due after more than one year.

16 Creditors: amounts falling due within one year

	Group		Company	
	2004 £000	2003 £000	**2004 £000**	2003 £000
Trade creditors	**4,110**	2,691	**–**	–
Amounts owed to Group undertakings	**–**	–	**38,486**	–
Corporation tax	**6,345**	3,140	**802**	240
Other taxation and social security	**1,123**	1,047	**–**	–
Other creditors	**1,969**	390	**–**	–
Accruals and deferred income	**57,672**	25,563	**7,575**	54
Dividends payable	**5,673**	6,106	**5,673**	6,106
	76,892	38,937	**52,536**	6,400

17 Creditors: amounts falling due after one year

	Group		Company	
	2004 £000	2003 £000	**2004 £000**	2003 £000
Accruals and deferred income	**1,732**	–	**–**	–
	1,732	–	**–**	–

18 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. On 23 December 2004, the Group acquired Artisan Components Inc., a company based in the US, who held significant US dollar cash and debtor balances. Most of the policies detailed below, except where noted, applied for the legacy ARM business prior to the acquisition, and reference to year-end amounts will include Artisan balances. The harmonisation of the legacy businesses' treasury policies is ongoing.

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 proportion of US dollar denominated costs for the Group going forward after the acquisition of Artisan increases from approximately 25% to approximately 45%). 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 2004 the Group had outstanding forward contracts to sell $50,000,000 (2003: $44,000,000). The Group had $56,205,000 (2003: $28,591,000) of trade debtors denominated in US dollars at that date, and US dollar cash balances and short-term investments of $176,464,000 (2003: $26,340,000). Thus 79% (2003: 20%) of the Group's US dollar current assets were not hedged by matching forward contracts at the year end. This has increased in the year due to the acquisition of Artisan which holds significant debtor and cash balances in US dollars.

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, Belgian and German 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.

The Group considers the use of other financial instruments such as currency options but did not enter into any agreements during the year.

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 during the year have been up to six months in length (although post-acquisition of Artisan there are some deposits with maturities of up to two years), 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.

The Group holds investments in two listed companies: a 12% holding in Superscape Group plc and a less than 1% holding in CSR plc. The Group holds investments in five private companies: Pixim, Inc., CoWare, Inc., Palmchip Corporation, Zeevo Inc. and Reciva Limited, which all develop products based on ARM technology.

External borrowings At 31 December 2004, the Group owed $3.3 million (£1,732,000) (2003: £nil) extending beyond one year but less than two years from the balance sheet date being the final payment of a technology license agreement signed in the year. No interest is payable under this arrangement. The Group had no undrawn committed borrowing facilities at 31 December 2004 (2003: £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. These balances are as of 31 December in each year, and the 2004 amounts may not be reflective of the typical profile of the Group throughout the year due to the significant impact of Artisan balances on the figures at the year end.

18 Financial instruments continued

Interest rate risk of financial assets

Group

	2004				2003		
Currency	Cash at bank and in hand £000	Short-term investments £000	Long-term marketable securities £000	Total £000	Cash at bank and in hand £000	Short-term investments £000	Total £000
Sterling	15,125	26,698	–	41,823	9,063	129,421	138,484
US dollars	59,421	32,488	5,438	97,347	15,663	–	15,663
European currencies (other than sterling)	2,610	–	–	2,610	1,915	–	1,915
Other currencies	1,037	–	–	1,037	3,482	242	3,724
At 31 December	78,193	59,186	5,438	142,817	30,123	129,663	159,786
Floating rate	78,193	–	–	78,193	30,123	–	30,123
Fixed rate	–	59,186	5,438	64,624	–	129,663	129,663
At 31 December	78,193	59,186	5,438	142,817	30,123	129,663	159,786

The fixed-rate cash and short-term investments in sterling and US dollars were placed with banks for between one week and one year and earn interest of between 1.00% and 4.88% (2003: 0.98% and 4.00%). Long-term marketable securities were placed for up to two years and earn interest of between 1.70% and 2.21%. Floating rate cash earns interest based on relevant national LIBID equivalents.

Financial liabilities Provisions for National Insurance and similar taxes of £27,000 (2003: £63,000) 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.

Long-term investments There is a readily available market for these investments. They are carried at cost unless the market value falls below cost in which case an impairment charge is made. At 31 December 2004, the fair value approximates to carrying value.

Foreign currency forward contracts The fair value of foreign currency forward contracts is estimated using the settlement rates. The fair value of forward contracts is estimated at £1,674,000 at 31 December 2004 (2003: £2,015,000). The decrease is due to the number and relative exchange rates of contracts outstanding compared to 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 2004: £1,973,000) 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 2004. On this basis, the fair value of the Group’s listed investments were £10,262,000 at 31 December 2004 (2003: £4,139,000).

Long-term accruals The carrying amount of £1,732,000 approximates to fair value as the effect of discounting to present value is not considered material.

Provisions The carrying amount of £27,000 approximates to fair value as this is the amount which would be payable if the liability had crystallized at the balance sheet date.

18 Financial instruments continued

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

2004	US dollars £000	European currencies £000	Other currencies £000	Total £000
Functional currency of Group operation				
Sterling	**(711)**	**1,602**	**–**	**891**
Other currencies	**1,446**	**–**	**–**	**1,446**
Total	**735**	**1,602**	**–**	**2,337**

2003				
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)

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 2004	–	–	–	2,015	–	2,015
Arising in previous years included in 2004 income	–	–	–	(2,015)	–	(2,015)
Gains and losses not included in 2004 income	–	–	–	–	–	–
Arising in 2004	–	–	–	1,674	–	1,674
Gains and losses on hedges at 31 December 2004	**–**	**–**	**–**	**1,674**	**–**	**1,674**
Of which:						
Gains and losses expected to be included in 2005 income	–	–	–	1,674	–	1,674

Gains deferred at 31 December 2004 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.

19 Provisions for liabilities and charges

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

	Share option tax 2004 £000	Share option tax 2003 £000
At 1 January	**63**	16
Charged/(credited) to the profit and loss account	**(36)**	47
At 31 December	**27**	63

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.

20 Called-up share capital

Company	2004 £000	2003 £000
Authorised		
2,200,000,000 ordinary shares of 0.05 pence each (2003: 1,580,000,000)	**1,100**	790
Allotted, called-up and fully paid		
1,350,786,975 ordinary shares of 0.05 pence each (2003: 1,023,345,650)	**675**	512

On 23 December 2004, a resolution was passed to increase the authorised share capital of the Company by £310,000 by the creation of 620,000,000 ordinary shares of 0.05 pence each.

3,041,914 ordinary shares of 0.05 pence each were issued in the year for cash consideration of £1,311,000 as a result of the exercise of employee share options at various times during the year.

324,399,411 ordinary shares of 0.05 pence each were issued in the year as part of the consideration for the acquisition of Artisan Components Inc. The fair value of these shares at issue was £354,835,000. For further information, see note 23.

Share options The Company had the following options outstanding over ordinary shares of 0.05 pence at 31 December 2004:

	Year of grant	Number of options	Range of exercise prices £	Weighted average exercise price £	Latest date of exercise
Executive Scheme	1996	120,000	0.02	0.02	14 July 2006
	1997	420,000	0.026	0.026	4 March 2007
	1998	386,000	0.1125 – 0.5275	0.1935	15 October 2008
	1999	2,507,297	1.224 – 4.26	1.3285	15 November 2009
	2000	403,746	6.136 – 7.738	6.5008	21 May 2010
	2001	671,662	2.84 – 3.75	3.3872	5 November 2011
	2002	918,980	2.465	2.465	18 April 2012
	2003	3,512,198	0.4375	0.4375	29 January 2013
	2004	1,146,349	1.0575 – 1.25	1.2494	22 July 2014
		10,086,232		1.3437	
Unapproved Scheme	1998	35,000	0.3875	0.3875	7 June 2005
	1999	4,356,700	1.224 – 4.26	1.2779	15 November 2006
	2000	2,455,308	6.136 – 7.738	6.2196	12 October 2007
	2001	3,243,073	2.84 – 4.43	3.4703	5 November 2008
	2002	3,858,445	0.425 – 3.145	2.352	7 November 2009
	2003	14,537,615	0.4375 – 1.1475	0.4463	4 November 2010
	2004	9,023,580	0.9475 – 1.25	1.2351	21 October 2011
		37,509,721		1.568	
Unapproved Performance Scheme	2001	62,909	3.815	3.815	22 May 2008
	2002	630,411	2.1475 – 2.465	2.3524	27 May 2009
	2003	3,885,711	0.4375	0.4375	30 January 2010
	2004	1,792,308	1.25	1.25	30 January 2011
		6,371,339		0.8889	
US ISO Scheme	1998	16,567	0.1125 – 0.5275	0.3895	15 October 2005
	2000	850,250	6.136 – 7.738	6.2943	12 October 2005
	2001	1,189,650	2.84 – 4.43	3.4109	5 November 2006
	2002	1,433,639	0.425 – 3.145	2.3256	7 November 2007
	2003	5,085,970	0.4375 – 1.1475	0.4409	4 November 2008
	2004	3,113,289	0.9475 – 1.25	1.2125	21 October 2009
		11,689,365		1.6055	
French Scheme	2000	58,750	6.33	6.33	12 October 2007
	2001	155,000	3.35 – 4.43	3.4765	5 November 2008
	2002	168,125	0.425 – 3.145	2.3404	15 October 2009
	2003	700,550	0.4375 – 1.1475	0.4408	4 November 2010
	2004	401,508	0.9475 – 1.25	1.242	21 October 2011
		1,483,933		1.423	
Belgian Scheme	2003	243,200	1.1475	1.1475	4 November 2010
	2004	372,825	1.25	1.25	29 January 2011
		616,025		1.2095	

20 Called-up share capital continued

	Year of grant	Number of options	Range of exercise prices	Weighted average exercise price	Latest date of exercise
1993 Plan	1997	121,381	0.06 – 0.14	0.1341	27 May 2007
	1998	1,106,511	0.15 – 0.49	0.2075	17 December 2008
	1999	1,449,053	0.16 – 0.44	0.2447	5 December 2009
	2000	9,212,841	0.20 – 0.58	0.3151	28 December 2010
	2001	14,900,314	0.24 – 0.46	0.2535	30 December 2011
	2002	6,191,574	0.27 – 0.60	0.4048	30 December 2012
	2003	2,987,708	0.48 – 0.50	0.4964	27 February 2013
		35,969,382		0.3133	
1997 Plan	1999	167,721	0.19	0.19	29 July 2009
	2000	11,436	0.19	0.19	23 February 2010
		179,157		0.19	
2000 Plan	2001	8,659,031	0.22 – 0.28	0.2309	27 September 2011
	2002	910,571	0.24 – 0.27	0.2594	29 August 2012
		9,569,602		0.2336	
2003 Plan	2003	14,191,917	0.47 – 0.72	0.5029	22 October 2013
	2004	21,568,990	0.55 – 1.07	0.6936	15 December 2014
		35,760,907		0.6179	
Director Plan	2000	512,859	0.39 – 0.57	0.4216	17 April 2010
	2001	157,381	0.22 – 0.30	0.2724	15 April 2011
	2002	157,363	0.44	0.44	6 February 2012
	2003	2,511,860	0.45 – 0.50	0.4839	8 April 2013
	2004	1,082,705	0.55	0.55	10 March 2014
		4,422,168		0.4838	
Executive Plan	1998	1,098,135	0.06	0.06	19 November 2008
	1999	228,916	0.19	0.19	29 July 2009
		1,327,051		0.0824	
ND00 Plan	2000	484,187	0.19	0.19	19 October 2010
	2001	353,701	0.37	0.37	13 August 2011
	2002	327,989	0.37	0.37	21 August 2012
	2003	2,020,671	0.51	0.51	18 February 2013
		3,186,548		0.4314	
SAYE	2000	597	5.65	5.65	31 December 2005
	2001	16,495	3.069	3.069	31 December 2006
	2002	76,225	1.82537	1.82537	31 December 2007
	2003	5,259,264	0.5865	0.5865	31 December 2008
	2004	495,804	0.9435	0.9435	31 December 2009
		5,848,385		0.6347	
TOTAL		164,019,815			

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 Scheme, 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. Various options to directors under the Unapproved Scheme have certain performance criteria attached, which if met are exercisable after three years, otherwise they will become exercisable after seven years.

There are 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.

20 Called-up share capital continued

Upon the acquisition of Artisan in 2004, the Company assumed the share schemes of Artisan existing at acquisition. The schemes remained substantially the same as prior to the acquisition, other than the options became options to purchase shares in ARM Holdings plc instead of Artisan Components Inc. The number and value of options were amended in line with the conversion ratio as detailed in the merger agreement. The schemes assumed were the "1993 Plan", the "1997 Plan", the "2000 Plan", the "2003 Plan", the "Director Plan", the "Executive Plan" and the "ND00 Plan".

Under each plan, there are multiple vesting templates and vesting periods. The majority of the options were already vested upon acquisition, and the most common template was 25% vesting after one year, and then 6.25% vesting each quarter thereafter, until 100% vest after four years. Some options vest on a monthly basis, and some vest over five years. All options lapse ten years from the date of grant.

The Group also operates savings-related share option schemes for all employees and executive directors of the Group ("SAYE"). The number of options granted is related to the value of savings made by the employee. The period of savings is either three or five years, except under the US scheme where the period is two years. The option price is normally 85% of the market share price at grant, and the right to exercise normally only arises for a six-month period once the savings have been completed, except for the US scheme where the right to exercise only arises for a three-month period.

Under the Group's Long Term Incentive Plan, a further 5,003,724 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 and QUEST.

21 Share premium account and reserves

Group	Share premium account £000	Merger reserve £000	Foreign exchange reserve £000	Other reserve £000	Profit and loss account £000
At 1 January 2004	81,137	–	(2,088)	–	100,874
Foreign exchange difference on consolidation	–	–	(410)	–	–
Premium on exercise of share options	1,310	–	–	–	–
Premium on shares issued for acquisition	–	354,673	–	–	–
Costs related to share issue	–	(3,094)	–	–	–
Credit in respect of share options granted on acquisition	–	–	–	61,474	–
Shares allocated to satisfy exercises under SAYE schemes	–	–	–	–	12
Credit in respect of employee share awards	–	–	–	–	495
Retained profit for the financial year	–	–	–	–	23,470
At 31 December 2004	**82,447**	**351,579**	**(2,498)**	**61,474**	**124,851**

In accordance with Section 131 of the Companies Act 1985, the premium on the shares issued in part consideration for the acquisition of Artisan Components Inc. has been credited to the merger reserve. The total share consideration of £354,835,000 comprised £162,000 nominal value of 0.05 pence ordinary shares and £354,673,000 premium on those shares.

The foreign exchange reserve represents exchange differences arising on consolidation of foreign subsidiary undertakings.

The other reserve represents the fair value of share options granted to employees of Artisan Components Inc. as part consideration for the acquisition. A total of 90.4 million options with an exercise price of between 6 pence and 107 pence were granted with fair values of between 61 pence and 104 pence valued using the Black Scholes valuation model.

Own shares held Offset in the profit and loss reserve is an amount of £7,485,000 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 (2003: £1,438,000), being the cost of 5,000,000 (2003: 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 2004 but no awards have been made since the trust was created. As at 31 December 2004 and 2003, the trust held 5,000,000 shares (nominal value £2,500) with a market value of £5,525,000 at 31 December 2004 (2003: £6,425,000). 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.

21 Share premium account and reserves continued

Own shares held also include £6,047,000 (2003: £6,131,000), being the cost of 713,034 shares, nominal value £357 (2003: 721,080 shares, nominal value £361) held by the Group's QUEST, which was established by the Company during 1999 to acquire new shares in the Company for the benefit of employees and directors of the Group. During the year, 8,046 shares (2003: 1,075,674) 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 2004 was £788,000 (2003: £927,000). 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	Other reserve £000	Profit and loss account £000
At 1 January 2004	81,137	–	6,861
Premium on exercise of share options	1,310	–	–
Credit in respect of share options granted on acquisition	–	61,474	–
Shares allocated to satisfy exercises under SAYE schemes	–	–	12
Retained profit for the financial year	–	–	8,737
At 31 December 2004	**82,447**	**61,474**	**15,610**

The Company has taken advantage of merger relief and not recorded the premium on the issue of shares for the acquisition of Artisan Components Inc. (now known as ARM Physical IP Inc.).

22 Reconciliation of movements in Group shareholders' funds

	2004 £000	2003 £000
Profit attributable to shareholders	**32,012**	15,158
Equity dividends	**(8,542)**	(6,106)
	23,470	9,052
Other recognised gains and losses relating to the year	**(410)**	(1,425)
Credit in respect of employee share awards	**495**	150
New share capital issued	**163**	1
Shares allocated from QUEST to satisfy exercises under SAYE schemes	**12**	263
Fair value of share options granted on acquisition	**61,474**	–
Premium on issue of new shares (net of issue costs)	**352,889**	254
Net addition to shareholders' funds	**438,093**	8,295
Opening shareholders' funds	**180,435**	172,140
Closing shareholders' funds	**618,528**	180,435

23 Acquisition of subsidiary undertakings

On 16 August 2004, the Group acquired 100% of the issued share capital of Axys Design Automation Inc., a US company, for total consideration of £8,568,000. Furthermore, on 23 December 2004, the Group acquired 100% of the issued share capital of Artisan Components Inc., a US company, for total consideration of £546,622,000. The following table sets out the provisional book values of the identifiable assets and liabilities acquired and their fair value to the Group:

	Artisan Book value £000	Adjustments £000	Artisan Fair value to Group £000	Axys Fair value to Group £000
Tangible fixed assets	2,509	–	2,509	50
Intangible fixed assets	18,804	(18,804)	–	–
Debtors	15,078	–	15,078	270
Other debtors	3,672	–	3,672	74
Deferred tax asset	15,446	–	15,446	710
Cash, short- and long-term investments	82,567	–	82,567	107
Total assets	138,076	(18,804)	119,272	1,211
Creditors				
Trade and other creditors	(3,674)	–	(3,674)	(17)
Accruals and deferred revenue	(20,736)	–	(20,736)	(729)
Deferred tax liability	(736)	736	–	–
Total liabilities	(25,146)	736	(24,410)	(746)
Net assets	112,930	(18,068)	94,862	465
Goodwill			451,760	8,103
Total consideration			546,622	8,568
Satisfied by				
Cash consideration			122,315	6,433
Shares issued			354,835	–
Options granted			61,474	–
Contingent cash consideration*			–	1,665
Expenses (net of £3,094,000 of share issue costs taken to the merger reserve)			7,998	470
Total consideration			546,622	8,568

*The contingent consideration will be determined using various stepped criteria based on Axys' revenue bookings to new customers in the first year post-acquisition. The amount varies from $nil to a maximum of $3 million.

The book value of the assets and liabilities have been taken from the management accounts of each company at the date of acquisition at actual exchange rates on that date. Adjustments were made to the Artisan intangible assets and related deferred tax liabilities to adjust its balance sheet to UK GAAP.

The fair value of options granted on the acquisition of Artisan were calculated using the Black Scholes valuation model with volatility of between 80% and 94%, an average risk-free interest rate of 4.5%, an estimated life of between zero and six years, and a dividend yield of 0.7%.

There were no fair value adjustments for Axys as the fair value of assets and liabilities were deemed to equate to book value.

23 Acquisition of subsidiary undertakings continued

Artisan's profit after tax for the year ended 30 September 2004 was £10.7 million (measured under US GAAP) and for the period from 1 October 2004 until acquisition was a loss of £6.1 million (measured under US GAAP). The summarised profit and loss account for the period from 1 October 2004 until acquisition on 23 December 2004 is as follows:

	£000
Turnover	7,654
Operating expenses*	(16,672)
Operating loss	(9,018)
Interest receivable and similar income	328
Loss on ordinary activities before taxation	(8,690)
Tax on loss on ordinary activities	2,567
Loss for the period	(6,123)

* Operating expenses above include £8.8 million of non-recurring acquisition and restructuring costs.

Axys' profit after tax for the year ended 31 December 2003 was £13,000, and for the period from 1 January 2004 to acquisition was a loss after taxation of £874,000.

Neither acquisition made a material contribution to post-acquisition cash flows.

The acquisitions have been accounted for using acquisition accounting.

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

	2004 £000	2003 £000
Operating profit	**35,221**	18,439
Depreciation on tangible fixed assets	**9,927**	12,908
Loss/(profit) on disposal of tangible fixed assets	**20**	(6)
Amortisation of goodwill	**2,103**	1,299
Amortisation of other intangible assets	**2,621**	3,342
Amounts (written back)/written off unlisted investments	**(392)**	622
Decrease in stocks	**34**	584
(Increase)/decrease in trade debtors	**(1,679)**	3,458
Trade debtors converted to unlisted investments	**(112)**	–
(Increase)/decrease in prepayments and accrued income	**(3,659)**	2,689
Increase/(decrease) in trade creditors	**1,176**	(2,468)
Increase in other taxation and social security	**76**	223
Increase/(decrease) in accruals, deferred income and other creditors	**4,958**	2,453
Movement in provisions for liabilities and charges	**(36)**	47
LTIP compensation charge	**495**	150
Net cash inflow from operating activities	**50,753**	43,740

25 Reconciliation of net cash flow to movement in net funds

	2004 £000	2003 £000
Increase in cash for the year	**47,949**	27,139
Cash (inflow)/outflow from (sale)/purchase of short-term investments	**(102,965)**	3,650
Change in net funds from cash flows	**(55,016)**	30,789
Short- and long-term investments acquired with subsidiary	**37,926**	–
Non-cash items:		
Translation difference	**121**	(1,307)
Movement in net funds in the year	**(16,969)**	29,482
Net funds at start of the year	**159,786**	130,304
Net funds at end of the year	**142,817**	159,786

26 Analysis of net funds

	Cash at bank and in hand £000	Short-term investments £000	Long-term investments £000	Total £000
At 1 January 2004	30,123	129,663	–	159,786
Cash flow	3,201	(102,965)	–	(99,764)
Acquired with subsidiary undertakings (see note 23)	44,748	32,488	5,438	82,674
Translation differences	121	–	–	121
At 31 December 2004	**78,193**	**59,186**	**5,438**	**142,817**

27 Cash flow from acquisitions

	2004 £000	2003 £000
Acquisitions		
Purchase of shares	**(128,748)**	(3,335)
Acquisition expenses	**(4,317)**	(78)
Cash at bank and in hand	**44,748**	23
Net cash outflow from acquisitions	**(88,317)**	(3,390)

A further £7.2 million of acquisition expenses is expected to be paid in 2005, and is accrued at the balance sheet date.

28 Major non-cash transactions

During the year, the Group acquired Artisan Components Inc., and part of the consideration paid was in the form of ARM Holdings plc equity being issued to the former shareholders of Artisan. The fair value of the equity issued was £354,835,000. Further consideration in the form of approximately 90.4 million options to purchase shares in ARM Holdings plc were granted with a fair value of £61,474,000 (see note 23).

29 Capital commitments

Group	**2004 £000**	2003 £000
Capital expenditure that has been contracted for but has not been provided for in the financial statements	**1,179**	1,365

The Company had no capital commitments at 31 December 2004 and 2003.

30 Financial commitments and contingencies

At 31 December 2004, the Group had annual commitments under non-cancellable operating leases as follows:

	2004		2003	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
Expiring within one year	**385**	**1,295**	285	89
Expiring between two and five years inclusive	**2,450**	**226**	1,057	1,333
Expiring in over five years	**2,114**	**–**	2,114	–
	4,949	**1,521**	3,456	1,422

At 31 December 2004 and 2003 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. ARM answered Nazomi's complaint in July 2002, denying infringement. ARM moved for summary judgement and a ruling that the accused technology does not infringe. In September 2003, the United States District Court of Northern California granted ARM's motion, holding that the accused technology does not infringe Nazomi's patent. Nazomi appealed the District Court's ruling. On 7 September 2004, the Court of Appeals for the Federal Circuit heard the appeal and the decision of the Court is expected in the first half of 2005. Based on legal advice received to date, ARM has no cause to believe that the effect of the original ruling by the District Court will not be upheld.

31 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 paid royalty fees of £411,000 (2003: £nil) and made cross-licence payments of £14,000 (2003: £453,000) to Superscape Group plc, a company in which Mike Inglis is a non-executive director. Amounts owed to Superscape at 31 December 2004 were £nil (2003: £392,000).

During the year, the Group received license fees of £209,000 (2003: £157,000) and support and maintenance income of £37,000 (2003: £nil) from CSR plc, a company in which John Scarisbrick is a non-executive director. Amounts owed by CSR at 31 December 2004 were £nil (2003: £183,799).

There were no other related party transactions during 2004 or 2003 which require disclosure.

32 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 have arisen as a result of the Group's initial or annual 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. A deferred tax liability arises on the intangible assets, and is credited to the profit and loss account proportionately to the amortisation on the related intangible assets. 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, the associated amortisation charge and the associated deferred tax liability and income statement credit.

Valuation of consideration on business combination Under both US and UK GAAP, the fair value of consideration in a business combination includes the fair value of both equity issued and any share options granted as part of that combination, which are then used in the goodwill calculation. Under UK GAAP, any equity issued is valued at the fair value as of the date of completion, whilst under US GAAP, the equity is valued at the date the terms of the combination were agreed to and announced. For options, under US GAAP, the fair value is based upon the total number of options granted, both vested and unvested, whilst under UK GAAP the fair value only includes those that have vested, together with a pro-rata value for partially vested options. Furthermore, where there is contingent consideration for an acquisition, under UK GAAP this is recognised as part of the purchase consideration if the contingent conditions are expected to be satisfied, whilst under US GAAP it is only recognised if the conditions have actually been met.

Deferred stock-based compensation Under US GAAP, the intrinsic value of unvested stock options issued by an acquirer as part of a business combination in exchange for unvested share options of the acquiree is recorded as a debit balance within shareholders' funds. This amount is charged to the profit and loss account over the vesting period of the share options in accordance with FIN 28. Under UK GAAP, no such adjustment to shareholders' funds is made on acquisition. Although the same charge as under US GAAP is subsequently made to the profit and loss account, it is written back through reserves.

Fair values of assets and liabilities acquired The conventions under which the fair value of assets acquired and liabilities assumed in a purchase business combination is determined differ between UK and US GAAP, eg. in relation to the valuation of deferred revenue and related costs.

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.

32 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

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 and cash equivalents Under UK GAAP, cash does not include short-term deposits and investments which cannot be withdrawn without notice and without incurring a penalty. Such items are shown as short-term investments. Under US GAAP, deposits with a maturity of less than three months at inception which are convertible into known amounts of cash are included as cash and cash equivalents. Deposits with a maturity at inception of between three months and one year are shown as short-term investments.

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.

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

	2004 **£000**	2003 £000
Profit for the financial year as reported under UK GAAP	**32,012**	15,158
Adjustments for:		
Employer's taxes on share options	**(36)**	47
Compensation charge in respect of SAYE schemes	**(341)**	(310)
Compensation charge in respect of LTIP	**(124)**	(91)
Write-back of goodwill amortisation	**2,103**	1,299
Amortisation of intangibles	**(576)**	(42)
Write-off of in-process research and development	**(3,612)**	–
Deferred tax on intangibles	**190**	–
Embedded derivatives	**(732)**	(1,141)
Tax on UK and US employee share options	**(515)**	(966)
Impairment of marketable security	**(392)**	(938)
Net income as reported under US GAAP	**27,977**	13,016

32 **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

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

	2004 £000	2003 £000
Shareholders' funds as reported under UK GAAP	**618,528**	180,435
Adjustments for:		
Employer's taxes on share options	**27**	63
Cumulative difference on amortisation of goodwill	**4,816**	2,713
Cumulative difference on amortisation of intangibles	**(618)**	(42)
Cumulative write-off of in-process research and development	**(3,762)**	(150)
Deferred tax on intangibles	**190**	–
Embedded derivatives	**(2,823)**	(2,091)
Valuation of equity consideration on acquisition	**(82,435)**	–
Valuation of option consideration on acquisition	**17,476**	–
Deferred compensation on acquisition	**(9,579)**	–
Unrealised gain on marketable security	**4,845**	1,041
Dividends payable	**5,673**	6,106
Foreign exchange on revaluation of intangibles	**(11)**	–
Shareholders' equity as reported under US GAAP	**552,327**	188,075

c) Reconciliation of goodwill from UK to US GAAP

	2004 £000	2003 £000
Goodwill as reported under UK GAAP	**459,413**	2,091
Adjustments for:		
Cumulative difference on amortisation of goodwill	**4,816**	2,713
Cumulative write-off of in-process research and development	**(3,762)**	(150)
Valuation of equity consideration on acquisition	**(82,435)**	–
Valuation of option consideration on acquisition	**17,476**	–
Deferred compensation on acquisition	**(9,579)**	–
Separately identifiable intangible assets (net of deferred tax)	**(43,504)**	(302)
Contingent consideration	**(1,665)**	–
Fair value of deferred revenue and costs	**(499)**	–
Foreign exchange on revaluation of goodwill	**155**	–
Goodwill as reported under US GAAP	**340,416**	4,352

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

	2004 £000	2003 £000
Cash as reported under UK GAAP	**78,193**	30,123
Adjustment for short-term investments treated as cash equivalents under US GAAP	**32,368**	100,599
Cash and cash equivalents as reported under US GAAP	**110,561**	130,722

e) Reconciliation of UK GAAP short-term investments to US GAAP short-term investments and short-term marketable securities

	2004 £000	2003 £000
Short-term investments as reported under UK GAAP	**59,186**	129,663
Adjustment for short-term investments treated as cash equivalents under US GAAP	**(32,368)**	(100,599)
Short-term investments and short-term marketable securities as reported under US GAAP	**26,818**	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 70 to 90 of this report.

Selected consolidated financial data – US GAAP

	2000 £000	2001 £000	2002 £000	2003 £000	**2004** **£000**
Revenues	100,730	146,274	150,922	128,070	**152,897**
Cost of revenues	(11,647)	(17,289)	(13,185)	(11,022)	**(11,799)**
Operating expenses	(57,846)	(82,848)	(96,456)	(99,785)	**(109,587)**
Income from operations	31,237	46,137	41,281	17,263	**31,511**
Interest, net	3,912	4,470	4,373	4,801	**6,944**
Share of loss of equity affiliate	(85)	–	–	–	**–**
Gain on partial disposal of shares in equity affiliate	512	–	–	–	**–**
Minority interest	(192)	(303)	(232)	(105)	**–**
Income before income tax	35,384	50,304	45,422	21,959	**38,455**
Provision for income taxes	(6,007)	(16,302)	(13,785)	(8,943)	**(10,478)**
Net income	29,377	34,002	31,637	13,016	**27,977**
Diluted earnings per common share	2.9p	3.3p	3.1p	1.3p	**2.7p**
Research and development as a percentage of revenues	26.2%	25.3%	31.3%	37.6%	**32.8%**
Capital expenditure	£11,842	£17,349	£15,616	£3,605	**£5,036**
Cash, cash equivalents, short-term investments and marketable securities	£75,266	£104,467	£130,304	£159,786	**£142,817**
Shareholders' equity	£100,972	£135,845	£172,470	£188,075	**£552,327**
Total assets	£127,343	£175,814	£205,744	£222,997	**£637,937**
Employees at year end (number)	619	722	721	740	**1,171**

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 After strong year-on-year growth for the semiconductor industry in 2004, current expectations for 2005 are that there will be little or no growth over 2004. Despite this likely flatter trading environment, we expect 2005 to be a year of growth in dollar revenues for the Company.

Both the former ARM and Artisan stand-alone businesses enter 2005 with healthy order backlogs and sales pipelines which will underpin licensing revenues in 2005. In addition, both companies continue to enjoy good momentum in royalty revenues based on the increasing adoption of ARM and Artisan technology by semiconductor and OEM companies in recent years. The healthy order backlog and sales pipeline and strong momentum in royalty revenues gives confidence that dollar revenues in both underlying businesses are capable of growing in 2005.

The Company remains exposed to any further weakening in the US dollar against sterling given that more than 90% of total Company revenues are earned in US dollars. Following the acquisition of Artisan, approximately 45% of the Company's cost base will be incurred in US dollars, compared to approximately 25% for ARM prior to the acquisition of Artisan.

The Company has been profitable and robustly cash generative (before investing activities), with net cash inflows from operating activities of £46.5 million, giving rise to a year-end cash, cash equivalents, short-term investments and marketable securities balance of £142.8 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		
	2002 %	2003 %	**2004** **%**
Revenues			
Product revenues	88.1	88.2	**90.7**
Service revenues	11.9	11.8	**9.3**
Total revenues	100.0	100.0	**100.0**
Cost of revenues			
Product costs	4.3	4.8	**4.4**
Service costs	4.4	3.8	**3.3**
Total cost of revenues	8.7	8.6	**7.7**
Gross profit	91.3	91.4	**92.3**
Operating expenses			
Research and development	31.3	37.6	**32.8**
Sales and marketing	16.4	17.9	**15.7**
General and administrative	14.9	22.4	**20.4**
In-process research and development	–	–	**2.4**
Amortization of intangibles purchased through business combination	–	–	**0.4**
Restructuring costs	1.3	–	**–**
Total operating expenses	63.9	77.9	**71.7**
Income from operations	27.4	13.5	**20.6**
Interest, net	2.9	3.7	**4.5**
Minority interest	(0.2)	(0.1)	**–**
Income before income tax	30.1	17.1	**25.1**
Provision for income taxes	9.1	7.0	**6.8**
Net income	21.0	10.1	**18.3**

Total revenues Total revenues were £152.9 million in 2004, an increase of 19% from £128.1 million in 2003, which was a 15% decrease from £150.9 million in 2002. Revenues, expressed in dollars using applicable exchange rates for invoicing in currencies other than dollars, were $272.4 million in 2004, an increase of 32% over the $206.5 million in 2003. The actual average dollar exchange rate in 2004 was $1.83 (compared with the effective average rate for ARM of $1.78) compared with $1.64 in 2003. This had the effect of reducing total reported revenues by approximately £13.2 million.

Product revenues Product revenues consist of license fees, sales of development systems and royalties. Product revenues for 2002, 2003 and 2004 were £132.9 million, £113.0 million and £138.7 million, representing 88%, 88% and 91% of total revenues respectively.

License revenues decreased from £83.0 million in 2002 to £50.8 million in 2003, and then increased to £59.4 million in 2004 representing approximately 55%, 40% and 39% of total revenues in 2002, 2003 and 2004 respectively.

Licensing activity in 2004 demonstrated both the breadth of ARM's technology offer as well as the longevity of the products. Our partners have now been licensing products in the ARM7 family for more than 11 years, including an incremental 15 ARM7 licenses in 2004 and accounting for 9% of licensing revenues in 2004, compared with 18% in 2003 and 15% in 2002. There have been 31 new licenses for ARM9 products in 2004. Revenues from the ARM9 family have declined though, accounting for 43% of licensing revenues in 2002, 31% in 2003 and 23% in 2004. Although these proportions for ARM7 and ARM9 have fallen in 2004, we expect to see the licensing of both families of products for some time, demonstrating the relevance of having leading-edge technology at all performance points in the embedded microprocessor space. There are a growing number of cores available to license from the Company, including four products in the ARM11 family, offering many new security and power management features and OptimoDE™, the embedded signal processing technology discussed below. The Company has also signed initial partners for the next generation of ARM technologies, currently known as "Tiger" and "ServalE".

65 new licenses were signed in 2004 (compared to 51 in 2003) comprising 31 multi-use licenses and 34 per-use licenses. 15 of these licenses were for ARM11 products bringing the total number of ARM11 licenses signed to date to 25. ARM11 accounted for 17% of licensing revenue in 2004, compared to 10% in 2003 and 5% in 2002. 15 companies became new ARM partners during 2004 bringing the total number to 140 at the end of 2004. This total number of semiconductor partners was net of those companies that have signed licenses with ARM in the past but have since been acquired by other companies or who no longer have access to ARM technology for other reasons.

A significant proportion of licensing was to existing partners taking 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, increased in 2004 to £10.5 million from £8.9 million in 2003 and down from £12.6 million in 2002 representing approximately 18% of license revenues in 2004, 18% in 2003 and 15% in 2002.

An embedded software group within ARM was established in 2004 in order to capitalize on opportunities to generate revenue from software. This group is intended to drive growth in embedded software revenue, build on the strong foundation of the existing Java, Intelligent Energy Manager, TrustZone and Swerve product families and bring more focus to the development of enabling software technology to support further growth of licensing, development systems and data engines revenues. An example of the initiatives being undertaken by this unit is the announcement in 2004 of the development by ARM and Trusted Logic, the embedded systems security experts, of a new TrustZone technology optimized software solution to increase security for the mobile industry. ARM expects the new software to increase electronic transaction security on ARM Powered® mobile phones, set-top boxes and other consumer devices.

Following the acquisition of Adelante Technologies N.V., now ARM Belgium N.V., in July 2003, ARM formally announced the launch of its OptimoDE embedded signal processing technology at the Embedded Processor Forum in May 2004. ARM has introduced this technology to address the processing requirements of very data intensive consumer applications which are often outstripping the capabilities of general-purpose digital signal processors. The OptimoDE product, which comprises a configurable data engine (signal processor) together with related intellectual property and tools, will be deployed in systems alongside existing ARM microprocessor cores and other ARM technology, including the Axys electronic system level design tools, acquired in August 2004.

Revenues from the sale of development systems decreased from £23.1 million in 2002 to £17.9 million in 2003, but increased to £19.7 million in 2004 representing approximately 15%, 14% and 13% of total revenues in 2002, 2003 and 2004 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, but was 24% higher in 2004 compared to 2003. Sales of development systems continued to be affected by increased competition in the debug tools marketplace. The new management team and increased resources assigned to assist the development of the development systems business have continued to yield improvements in results through 2004 and this is expected to continue into 2005.

In August 2004, ARM added electronic system level (ESL) expertise to its RealView® design tools portfolio with the announcement of the acquisition of Axys Design Automation, Inc., a provider of fast, accurate, integrated processor and system modelling and simulation solutions. Axys' ESL products reduce overall system costs by allowing designs to be modelled early in the development cycle, decreasing time-to-market and minimizing design errors.

Royalties are either set as a percentage of the licensee's net sales price per chip or, less frequently, as a fixed amount and are recognized when the Company receives notification from the customer of product sales. In effect, this means that it is normally in the quarter following the shipments that data is received and so royalty data for a year reflects actual shipments made from the beginning of October of the previous year to the end of September of the current year. Royalties increased from £26.8 million in 2002 to £44.3 million in 2003, and increased further to £59.6 million in 2004, representing 18%, 34% and 39% of total revenues in 2002, 2003 and 2004 respectively. Volume shipments increased from 456 million units in 2002 to 782 million units in 2003, mainly due to increased production of a wide range of electronic devices, including wireless handsets, secure products and automotive products. Unit shipments in 2004 were 1,272 million, with the increase in volumes coming from all market segments, especially consumer entertainment and storage products. The Company has become less reliant on the wireless sector with more than 400 million non-wireless units being shipped in the year. The Company expects the trend of increasing proportions of unit shipments into the non-wireless markets to continue into 2005. The Company expects royalty revenues to grow year on year although they may be subject to significant fluctuations from quarter to quarter. The total number of partners shipping ARM technology-based product at the end of 2004 was 60 after taking into account corporate activity within the ARM partnership.

Service revenues Service revenues consist of design consulting services and revenues from support, maintenance and training. Service revenues decreased from £18.0 million in 2002 to £15.1 million in 2003 to £14.2 million in 2004, representing 12%, 12% and 9% of total revenues in 2002, 2003 and 2004 respectively. Consulting revenues decreased from £4.4 million in 2002 to £2.4 million in 2003 and £2.1 million in 2004, as engineering resource was directed away from consulting projects to research and development activities. Revenues from support, maintenance and training decreased from £13.6 million in 2002 to £12.7 million in 2003 and £12.1 million in 2004. Actual US dollar revenues increased by 3% from 2003 to 2004 but this has been offset by the weakening of the dollar against sterling in 2004.

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 2004 was 51% of revenues coming from the US, 21% from Japan, 13% from Asia Pacific, excluding Japan, and 15% from Europe. In 2003, revenues from the US represented 51%, Japan 19%, Asia Pacific, excluding Japan, 12%, and Europe 18%. In 2002, revenues from the US represented 44%, Japan 25%, Asia Pacific, excluding Japan, 13%, and Europe 18%.

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 £6.5 million in 2002, £6.2 million in 2003 and £6.7 million in 2004 representing 4%, 5% and 4% of total revenues in 2002, 2003 and 2004 respectively. Approximately two-thirds of total product cost of sales were made up of development systems costs in 2004, with the balance comprising additional costs related to the costs of third-party licenses and cross-license payments to collaborative partners. This is comparable to the level in both 2002 and 2003, with the balance being costs associated with third-party licenses. Product gross margin in 2004 was 95%, compared to 95% in 2003 and 95% in 2002. The Company does not currently expect a significant increase in product costs in 2005, 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 £6.7 million in 2002 to £4.9 million in 2003 and was £5.1 million in 2004. The gross margins earned on service revenues were approximately 63% in 2002, 68% in 2003 and 64% in 2004. In 2003 and 2004, 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 £47.3 million in 2002 to £48.1 million in 2003 and £50.1 million in 2004, representing 31%, 38% and 33% of total revenues in 2002, 2003 and 2004 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.

Total engineering headcount increased from 420 at the end of 2002 to 442 at the end of 2003, and was 739 at the end of 2004. The increase in 2003 was predominantly due to the acquisition of ARM Belgium N.V., whilst the increase in 2004 was due to the acquisitions of both Artisan and Axys as well as some growth within the existing business.

Sales and marketing Sales and marketing expenditure decreased from £24.7 million in 2002 to £23.0 million in 2003 and was £23.9 million in 2004, representing 16% of total revenues in 2002, 18% in 2003, and 16% in 2004. Headcount in this area decreased from 208 at 31 December 2002 to 203 at 31 December 2003 and was 282 at the end of 2004. Most of the growth in 2004 has come from acquisitions but there has also been organic growth with new offices opening in Bangalore, India and Beijing, PR China. The total number of sales offices is currently 19 and this enables improved contact with the Company's geographically diverse customer base.

General and administrative General and administrative headcount at 31 December 2004 was 150, up from 95 at the end of 2003 and 93 at the end of 2002. Again, the majority of the increase in 2004 has come from acquisitions. General and administrative costs were £22.5 million in 2002 and increased to £28.7 million in 2003 and £31.3 million in 2004, representing 15%, 22% and 20% of total revenues respectively. Costs in 2003 included £1.6 million of impairments made to investments (2002: £0.8 million, 2004: £nil). Legal costs fluctuated from £2.5 million in 2002 to £9.1 million in 2003 and £5.1 million in 2004, 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 in 2003 for settlement of the Herodion arbitration which was paid early in 2004. £4.5 million of the costs in 2004 related to a technology license agreement signed in the year. Expense in relation to provisions for doubtful debts was £1.4 million in 2002, a release of £0.1 million in 2003 and a further release of £0.1 million in 2004. Unrealized future foreign exchange losses on certain committed but not yet invoiced future revenue streams of £0.7 million (2003: £1.1 million; 2002: £1.0 million) were recorded in accordance with SFAS 133. There was a gain on foreign exchange of £0.5 million in 2002, a gain of £0.9 million in 2003 and a loss of £1.5 million in 2004. See "foreign currency fluctuations" below.

In-process research and development During 2004, the Company purchased Axys Design Automation Inc. and Artisan Components Inc. (now ARM Physical IP Inc.). Those intangible assets that were still in development (known as in-process research and development) were charged directly to the income statement, amounting to £0.4 million and £3.2 million for Axys and Artisan respectively.

Amortization of goodwill and intangible assets Various licenses to use third-party technology have been signed over the past several years, with their values being capitalized and amortized over the useful economic period that the Company is expected to gain benefit from them (generally between three and five years). In addition to the three licenses purchased in 2000, 2001 and 2002, two licenses were purchased in 2003 totalling £0.7 million and a further license purchased in 2004 for £0.2 million. Amortization of these licenses amounted to £0.5 million in 2004 (2003: £1.2 million; 2002: £1.1 million).

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, £2.0 million in 2003 and £2.0 million in 2004.

The Company also purchased a patent for £0.7 million in 2002 which is being amortized over five years. The amortization charge was £0.1 million in 2002, 2003 and 2004.

During 2003, the Company purchased Adelante Technologies N.V. (now ARM Belgium N.V.). Included with the assets purchased were £0.3 million of intangible assets comprising developed technology and customer relationships which are being amortized over five years and two years respectively. The amortization charge for the assets during 2004 was £0.1 million (2003: less than £0.1 million).

Intangible assets acquired and capitalized as part of the Axys and Artisan business combinations totalled £1.9 million and £70.1 million respectively and are being amortised over five years and between one and six years respectively (see note 6 for further details). The total charge during 2004 was £0.1 million and £0.3 million for Axys and Artisan respectively.

The adoption of SFAS 142, "Goodwill and other intangible assets", in 2002 did not result in any impairment of the Company's goodwill or intangible assets.

During the year, the Company entered into a technology license agreement under which ARM will pay $13.3 million (£6.9 million) in four equal, semi-annual installments over two years. The first installment was paid during the year and the remainder is included with creditors. The agreement confers both retrospective and prospective rights, each of which has been valued based on a discounted cash flow analysis, and the arrangement consideration has been allocated to each element based on the relative fair values. The retrospective amount, amounting to £4.5 million, has been charged to administrative expenses in the income statement in the year, and the prospective element, amounting to £2.4 million, has been accounted for as a prepayment at 31 December 2004.

Interest Interest receivable increased from £4.4 million in 2002 to £4.8 million in 2003 and further to £6.9 million in 2004. The growth in interest in the periods was due to higher average cash balances and increasing interest rates. The Company invested cash balances over periods of up to six months during 2004 although some marketable securities acquired with Artisan have maturities of greater than one year from the balance sheet date.

Income before income tax Income before income tax was £45.4 million in 2002, £22.0 million in 2003 and £38.5 million in 2004, representing 30%, 17% and 25% of total revenues respectively. The drop in margins 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. The increased margin in 2004 was achieved, notwithstanding non-recurring and acquisition-related charges of £8.7 million during the year (comprising £4.5 million of a non-recurring technology license charge, £3.6 million of in-process research and development write-off and £0.6 million of business combination intangible amortization) due to higher revenue and continued cost control.

Tax charge The Company's effective tax rates were 30.3% in 2002, 40.7% in 2003 and 27.2% in 2004. The effective tax rate increased in 2003 due to the impact of certain cash and non-cash accounting charges not being deductible for tax purposes, but fell in 2004 with additional costs being allowable for research and development tax credits, additional benefits arising from employee share option exercises and lower non-deductible non-cash accounting charges in 2004.

Net income Net income was £31.6 million in 2002, £13.0 million in 2003 and £28.0 million in 2004. The changes in net income are as a result of the combined movements in revenues and costs as discussed above.

Liquidity and capital resources The Company's operating activities generated net cash of £39.5 million, £38.7 million and £46.5 million in 2002, 2003 and 2004 respectively. Movements of working capital detailed below are per the cash flow and thus exclude balances acquired through business combinations, except where noted.

Accounts receivable fell by £2.9 million in 2002, a further £4.5 million in 2003 but increased by £1.4 million in 2004. This is partly due to the overall revenues earned in the periods towards the end of the respective years and also improved credit control throughout the periods. Prepaid expenses increased by £5.3 million in 2002, fell by £2.8 million in 2003 and increased again by £3.4 million in 2004. 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. This has been similar in 2004 and the increase was due to a technology license agreement signed in the year giving rise to a prepayment as noted above.

Accounts payable increased by £2.4 million in 2002, reduced by £2.5 million in 2003 and increased again in 2004 by £1.2 million, as a result of the timing of receipt of supplier invoices in 2004 and a general increase in the Company's cost base. Accrued liabilities reduced by £1.1 million in 2002, increased by £7.0 million in 2003 and increased by a further £2.8 million in 2004. The significant increase in 2003 was primarily as a result of the provision for the Herodion legal settlement of £6.4 million which was paid early in 2004, and increased in 2004 as a result of provisions for staff costs and for a technology license agreement signed in the year.

At 31 December 2004, the Company recorded approximately £21.4 million in deferred revenues which represented cash or receivables scheduled to be recognized as revenues in varying amounts after 31 December 2004. At 31 December 2003 and 31 December 2002, the Company recorded approximately £11.1 million and £14.4 million respectively in deferred revenues. Deferred revenues are an element of customer backlog, and represent amounts invoiced to customers not yet recognized as revenues in the income statement. As such, this balance fluctuates due to the maturity profile of ARM's products, and invoicing milestones within contracts. The significant increase in 2004 is predominantly due to the acquisition of Artisan.

The Company believes that, given its current level of business, it has sufficient working capital for the foreseeable future.

Cash flow from operations has been used to fund the working capital requirements of the Company as well as capital expenditure. Capital expenditure in 2004 was £5.0 million, compared with £3.6 million in 2003 and £15.6 million in 2002. Capital expenditure in 2003 was much lower than in 2002 as a result of the increased leasing of design automation tools and the much lower level of recruitment (which required computers to be purchased for new staff). Capital expenditure increased in 2004 with increases in both levels of staff and as a result of the development of a new IT system. 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 2004, £3.5 million was spent on computer equipment and software and £1.5 million on leasehold improvements and fixtures and fittings.

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 ARM Belgium N.V.) for a total consideration of £0.4 million.

In 2004, the Company acquired the entire share capital of both Axys Design Automation Inc. and Artisan Components Inc. for total consideration of £6.9 million and £481.7 million respectively with cash consideration comprising £6.9 million and £122.3 million respectively. A further $3 million (£1.6 million) may become payable for Axys subject to the achievement of various post-acquisition financial milestones. Cash acquired with these businesses amounted to £82.7 million. The Company envisages making further 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 2002, the Company made one investment in an available-for-sale security, namely Superscape Group plc, for 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. In 2004, the Company invested a total of £0.2 million in two small unlisted companies, Zeevo Inc. and Reciva Limited, giving a minority holding of less than 3% in each company.

Cash, cash equivalents, short-term investments and marketable securities balances at 31 December 2004 were £142.8 million compared to £159.8 million at 31 December 2003. Accounts receivable net of allowances for doubtful debts were £17.3 million at 31 December 2003 and £34.3 million at 31 December 2004. The significant increase in 2004 is due to the inclusion of the Artisan accounts receivable at the balance sheet date.

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 exposure 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 $7.2 million in 2002, $4.6 million in 2003 and $5.1 million in 2004. 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 2002, 2003 and 2004 are disclosed in note 14 to the financial statements. The settlement period of the forward contracts outstanding at 31 December 2004 was between 11 January 2005 and 29 March 2005.

Quantitative and qualitative information on market risk During the preceding fiscal year, the Company was exposed to foreign currency exchange risk inherent in its sales commitments, anticipated sales, anticipated purchases and assets and liabilities denominated in currencies other than sterling. ARM transacts business in approximately eight foreign currencies worldwide, of which the most significant to the Company's operations were the US dollar, the euro, the Korean won and the Japanese yen in 2004. For most currencies, the Company is a net receiver of foreign currencies and therefore benefits from a weaker sterling and is adversely affected by a stronger sterling relative to those foreign currencies. The Company has performed a sensitivity analysis at 31 December 2004, 2003 and 2002, using a modelling technique that measures the changes in the fair values arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to sterling with all other variables held constant. The analysis covers all of the Company's foreign currency contracts offset by the underlying exposures. The foreign currency exchange rates used were based on market rates in effect at 31 December 2004, 2003 and 2002. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a loss in the fair values of ARM's foreign exchange derivative financial instruments, net of exposures, of £8.6 million at 31 December 2004 (2003: £0.7 million, 2002: £0.2 million). The increase in 2004 is due to the large dollar cash balances within Artisan at the year end.

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.

Consolidated statements of income and comprehensive income/US GAAP

	2002 £000	2003 £000	**2004 £000**	**2004* $000**
Revenues				
Product revenues	132,911	112,958	**138,732**	**266,365**
Service revenues	18,011	15,112	**14,165**	**27,197**
Total revenues	150,922	128,070	**152,897**	**293,562**
Cost of revenues				
Product costs	(6,464)	(6,171)	**(6,735)**	**(12,931)**
Service costs	(6,721)	(4,851)	**(5,064)**	**(9,723)**
Total cost of revenues	(13,185)	(11,022)	**(11,799)**	**(22,654)**
Gross profit	137,737	117,048	**141,098**	**270,908**
Operating expenses				
Research and development	(47,299)	(48,131)	**(50,133)**	**(96,255)**
Sales and marketing	(24,711)	(22,960)	**(23,935)**	**(45,955)**
General and administrative	(22,486)	(28,652)	**(31,331)**	**(60,156)**
In-process research and development	–	–	**(3,612)**	**(6,935)**
Amortization of intangibles purchased through business combination	–	(42)	**(576)**	**(1,106)**
Restructuring costs	(1,960)	–	**–**	**–**
Total operating expenses	(96,456)	(99,785)	**(109,587)**	**(210,407)**
Income from operations	41,281	17,263	**31,511**	**60,501**
Interest, net	4,373	4,801	**6,944**	**13,333**
Minority interest	(232)	(105)	**–**	**–**
Income before income tax	45,422	21,959	**38,455**	**73,834**
Provision for income taxes	(13,785)	(8,943)	**(10,478)**	**(20,118)**
Net income	31,637	13,016	**27,977**	**53,716**
Net income	31,637	13,016	**27,977**	**53,716**
Other comprehensive income:				
Foreign currency adjustments	(807)	(1,425)	**(421)**	**(808)**
Unrealised holding gain on available-for-sale securities, net of tax of £1,631,000 (2003: £446,000; 2002: £nil)	–	1,979	**4,196**	**8,056**
Total comprehensive income	30,830	13,570	**31,752**	**60,964**
Basic earnings per common share	3.1p	1.3p	**2.7p**	
Diluted earnings per common share	3.1p	1.3p	**2.7p**	

*US dollar amounts have been translated from sterling at the 31 December 2004 closing rate of £1 = $1.92 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

	2003 £000	**2004 £000**	**2004* $000**
Assets			
Current assets:			
Cash and cash equivalents	130,722	**110,561**	**212,277**
Short-term investments	29,064	**5,307**	**10,190**
Marketable securities	–	**21,511**	**41,301**
Accounts receivable, net of allowances for doubtful debts of £1,451,000 (2003: £1,115,000)	17,320	**34,347**	**65,946**
Inventory: finished goods	931	**897**	**1,722**
Prepaid expenses and other assets	8,924	**16,001**	**30,722**
Total current assets	186,961	**188,624**	**362,158**
Long-term marketable securities	–	**5,438**	**10,441**
Deferred income taxes	3,139	**2,529**	**4,855**
Property and equipment, net	16,583	**14,117**	**27,105**
Goodwill	4,352	**340,416**	**653,599**
Other intangible assets	5,716	**74,578**	**143,190**
Investments	6,246	**12,235**	**23,491**
Total assets	222,997	**637,937**	**1,224,839**
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	2,691	**4,110**	**7,891**
Income taxes payable	3,140	**6,345**	**12,182**
Personnel taxes	1,047	**1,123**	**2,156**
Accrued liabilities (see footnote 10)	16,912	**38,600**	**74,112**
Deferred revenue	11,132	**21,355**	**41,002**
Total current liabilities	34,922	**71,533**	**137,343**
Accrued liabilities	–	**1,732**	**3,326**
Deferred income taxes	–	**12,345**	**23,702**
Total liabilities	34,922	**85,610**	**164,371**
Contingencies and commitments (see footnote 12)			
Shareholders' equity			
Ordinary shares: £0.0005 par value; 2,200,000,000 authorized (2003: 1,580,000,000); 1,350,786,975 issued (2003: 1,023,345,650)	512	**675**	**1,296**
Additional paid-in capital	63,321	**414,133**	**795,135**
Deferred compensation	(2,499)	**(12,083)**	**(23,199)**
Treasury stock, at cost: 5,713,034 ordinary shares (2003: 5,721,080)	(7,569)	**(7,485)**	**(14,371)**
Retained earnings	134,419	**153,421**	**294,568**
Accumulated other comprehensive income:			
Unrealized holding gain on available-for-sale securities, net of tax of £2,077,000 (2003: £446,000)	1,979	**6,175**	**11,856**
Cumulative translation adjustment	(2,088)	**(2,509)**	**(4,817)**
Total shareholders' equity	188,075	**552,327**	**1,060,468**
Total liabilities and shareholders' equity	222,997	**637,937**	**1,224,839**

*US dollar amounts have been translated from sterling at the 31 December 2004 closing rate of £1 = $1.92 and are unaudited (see footnote 1).

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

Consolidated statements of cash flows/US GAAP

	2002 £000	2003 £000	**2004 £000**	**2004* $000**
Cash flows from operating activities				
Net income	31,637	13,016	**27,977**	**53,716**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of tangible and intangible assets	15,240	16,292	**13,124**	**25,198**
Write-off of in-process research and development	–	–	**3,612**	**6,935**
Stock option compensation	56	551	**960**	**1,843**
Deferred income taxes	(858)	(1,248)	**(1,281)**	**(2,460)**
Tax effect of disqualifying dispositions	754	966	**515**	**989**
Provision for doubtful accounts	1,393	(1,078)	**(321)**	**(616)**
Accounts receivable converted to trade investments	–	–	**(112)**	**(215)**
Amount written off investments	826	1,560	**–**	**–**
Other	218	99	**20**	**38**
Changes in operating assets and liabilities:				
Accounts receivable	2,900	4,536	**(1,358)**	**(2,607)**
Inventory	(934)	584	**34**	**65**
Prepaid expenses and other current assets	(5,339)	2,806	**(3,370)**	**(6,470)**
Accounts payable	2,369	(2,468)	**1,176**	**2,258**
Income taxes payable	(2,676)	(688)	**(357)**	**(685)**
Deferred revenue	(5,005)	(3,397)	**3,013**	**5,785**
Accrued liabilities and other creditors	(1,105)	6,991	**2,771**	**5,320**
Personnel taxes	40	223	**76**	**146**
Net cash provided by operating activities	39,516	38,745	**46,479**	**89,240**
Cash flows from investing activities:				
Purchase of equipment	(8,670)	(1,574)	**(3,933)**	**(7,552)**
Purchase of leasehold improvements	(6,946)	(1,737)	**(1,397)**	**(2,682)**
Sale of equipment	35	34	**23**	**44**
Purchase of patent and licenses	(855)	(655)	**(65)**	**(125)**
Purchase of investments	(1,500)	(1,152)	**(50)**	**(96)**
(Purchase)/maturity of short-term investments	–	(29,064)	**24,677**	**47,380**
Purchase of subsidiaries and businesses, net of cash acquired	–	(3,390)	**(77,899)**	**(149,566)**
Net cash used in investing activities	(17,936)	(37,538)	**(58,644)**	**(112,597)**
Cash flows from financing activities:				
Cash received on issue of shares on exercise of share options	4,763	255	**1,311**	**2,517**
Proceeds received on issuance of shares	222	263	**2**	**4**
Expenses of issuing share capital	–	–	**(360)**	**(691)**
Payment of dividends	–	–	**(8,975)**	**(17,232)**
Net cash provided by/(used in) financing activities	4,985	518	**(8,022)**	**(15,402)**
Effect of foreign exchange on cash and cash equivalents	(728)	(1,307)	**26**	**50**
Net increase/(decrease) in cash and cash equivalents	25,837	418	**(20,161)**	**(38,709)**
Cash and cash equivalents at beginning of the period	104,467	130,304	**130,722**	**250,986**
Cash and cash equivalents at end of the period	130,304	130,722	**110,561**	**212,277**
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	16,758	9,925	**11,601**	
Cash received on interest	4,187	4,930	**7,233**	

*US dollar amounts have been translated from sterling at the 31 December 2004 closing rate of £1 = $1.92 and are unaudited (see footnote 1).

In addition, shares have been issued as part consideration for a business combination, and further details are shown in footnote 6.

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

Consolidated statements of changes in shareholders' equity/US GAAP

	Number	Ordinary shares Amount £000	Additional paid-in capital £000	Deferred compensation £000	Treasury stock £000	Retained earnings* £000	Unrealized holding gain £000	Cumulative translation adjustment £000	Total £000
Balances, 31 December 2001	1,014,767,176	507	65,362	–	(19,934)	89,766	–	144	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	(313)	(18,034)	121,403	–	(663)	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 disqualfying 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	(2,499)	(7,569)	134,419	1,979	(2,088)	188,075
Shares issued on exercise of options	3,041,914	1	1,310						1,311
Shares issued on acquisition	324,399,411	162	272,238						272,400
Share issue costs			(3,094)						(3,094)
Issuance of options in relation to acquisition of Artisan			78,950	(9,579)					69,371
Net income						27,977			27,977
Dividends						(8,975)			(8,975)
Unrealized holding gains on available-for-sale securities							4,196		4,196
Tax effect of disqualfying dispositions			515						515
Deferred compensation arising on share schemes			965	(965)					–
Amortization of deferred compensation				960					960
Currency translation adjustment								(421)	(421)
Issuance of shares			(72)		84				12
Balances, 31 December 2004	**1,350,786,975**	**675**	**414,133**	**(12,083)**	**(7,485)**	**153,421**	**6,175**	**(2,509)**	**552,327**

*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 2004 such distributable profits amounted to £15,610,000 after taking into account the proposed final dividend of £5,673,000 for 2004.

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.

The Company's wholly-owned undertakings include ARM Limited (incorporated in the UK), ARM, Inc. (incorporated in the US), ARM Physical IP Inc. (formerly Artisan Components Inc., incorporated in the US and acquired and renamed during 2004), Axys Design Automation Inc. (incorporated in the US and acquired during 2004), ARM KK (incorporated in Japan), ARM Korea Limited (incorporated in South Korea), ARM France SAS (incorporated in France), ARM Belgium N.V. (incorporated in Belgium), ARM Taiwan Limited (incorporated in Taiwan), ARM Consulting (Shanghai) Co. Limited (incorporated in PR China) and ARM Embedded Solutions Pvt. Ltd. (incorporated in India).

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 2004 consolidated financial statements have been translated from sterling at the closing rate per the Financial Times on 31 December 2004 of £1.00 = $1.92. 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. Significant estimates in the financial statements include, but are not limited to, revenue recognition, accounting for investments, allowance for doubtful debts, impairment of long-lived assets, goodwill and purchased intangible assets and contingencies and legal settlements.

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 2004 and 2003, the estimated fair value of these investments approximated their recorded basis, based on estimates determined by management.

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. In 2004, the Company made a less than 1% investment in Zeevo Inc. and a less than 3% investment in Reciva Limited.

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.

Although an independent valuation is made of any intangible assets purchased as part of a business combination, management is primarily responsible for determining the fair value of intangible assets. Such assets are capitalized and amortized over a period of one to six 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.

Where a technology confers both retrospective and prospective rights, each element is valued based on a discounted cash flow analysis. The retrospective element is charged to the income statement immediately, whilst the prospective element is capitalized.

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 was 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. The Company performs its annual impairment review at the reporting unit level. For 2004, all the assets and liabilities of the Company were assigned to one reporting unit. An annual impairment review in 2004 determined, by way of a comparison of the Company's market capitalization to shareholders' equity and cash flow forecasts, that there was no indication of impairment with respect to goodwill.

Impairment charges The Company reviews long-lived assets, identifiable intangibles and related goodwill for impairment annually or more frequently if 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.

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. If the amount of revenue recognized exceeds the amounts billed to customers, the excess amount is recorded as unbilled accounts receivable. Estimates of total project requirements 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 (as opposed to unspecified upgrades and enhancements) 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 Company recognizes license revenue when a signed contract or other persuasive evidence of an arrangement exists, the product has been shipped or electronically delivered, the license fee is fixed and determinable and collection of the resulting receivable is probable. Where agreements include multiple elements, the revenue recognition criteria for each element are typically met within the same reporting period, ie. on delivery of the elements. If an element is undelivered at a period end, the Company determines whether it has sufficient vendor specific objective evidence (VSOE) of fair value in order to make an allocation amongst the elements. With the exception of post-contract support (PCS), the Company does not currently believe that it has sufficient VSOE to make such allocations. Accordingly, no revenue is recognized on arrangements where deliverables other than PCS remain outstanding.

PCS consists of an identified customer contact at the Company, and telephone or e-mail support (including certain bug fixes). PCS is generally priced separately from the initial licensing fee. Revenue allocated to PCS is determined based on VSOE. VSOE is determined with reference to contractual renewal rates, or, if none are specified, by reference to the rate actually charged on renewal for the same level of support and for the same or similar technologies for PCS arrangements. PCS revenue is recognized on a straight-line basis over the period for which support and maintenance is contractually agreed by the Company with the licensee.

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 and considers itself to be the principal under EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent", 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.

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. While some arrangements with distributors provide very limited rights of return, the Company's history is that actual returns are negligible and accordingly no provisions are deemed necessary.

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.

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

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.

Revenues from consulting projects, which are typically of a short duration, are 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, revenues are recognized on a percentage-to-completion basis as milestones are achieved. This method approximates to percentage to completion based on labor inputs.

Where the Company enters into a license arrangement in exchange for a license to the customer's technology, in the absence of evidence of fair value of the arrangement, the transaction is recorded at carry-over basis.

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 2004 were £338,000 (2003: £226,000; 2002: £199,000) 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 2002, 2003 and 2004 were £1,894,000, £1,848,000 and £2,067,000 respectively.

Cash and 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 and marketable securities 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. Any investments with a maturity date of greater than one year are classified as long-term. At 31 December 2004 and 2003, all of the Company's investments were classified as available-for-sale and were recorded on the balance sheets at fair value. Unrealized gains and losses on these investments are recorded in comprehensive income. The Company recognizes an impairment charge when the decline in fair value of its investments below cost is judged to be other-than-temporary.

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. Costs that are directly attributable to the development of new business application software and which are incurred during the period prior to the date that the software is placed into operational use, are capitalized. External costs and internal costs are capitalized to the extent they enhance the future economic benefit of the business.

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 to five 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 even if the payments are not made on such a basis.

Currency translation The functional currency for the Company's operations is the local currency in which each operation 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 monthly exchange rates during the year. Translation differences are taken to the cumulative translation adjustment.

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

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 2004 the loss on exchange was £732,000 (2003: £1,141,000; 2002: £950,000).

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 2004 excludes incremental shares of approximately 38,143,000 (2003: 18,948,000; 2002: 19,608,000) 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 £341,000 (2003: £310,000) and in respect of the LTIP of £619,000 (2003: £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		
	2002 £000	2003 £000	**2004** **£000**
Net income:			
As reported	31,637	13,016	**27,977**
Deduct: Total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects	(11,165)	(15,794)	**(12,546)**
Add back: Total stock-based compensation expense determined under the intrinsic value-based method	56	551	**960**
Pro forma net income/(loss)	20,528	(2,227)	**16,391**
Basic earnings/(loss) per common share (pence):			
As reported	3.1p	1.3p	**2.7p**
Pro forma	2.0p	(0.2p)	**1.6p**
Diluted earnings/(loss) per common share (pence):			
As reported	3.1p	1.3p	**2.7p**
Pro forma	2.0p	(0.2p)	**1.6p**

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for grants in 2004, 2003 and 2002: risk-free interest rate of between 4.0% and 4.5% (2003: between 3.2% and 4.9%; 2002: 5.1%); expected life of between one and five years; between 44% and 96% (2003: between 60% and 127%; 2002: 80%) volatility; and dividend yield of between 0.5% and 0.7% (2003 and 2002: nil). The grant date fair value of options granted during 2004 ranged from £0.30 to £0.88 (2003: £0.21 to £0.55, 2002: £0.26 to £1.95).

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

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 2004 is £341,000 (2003: £310,000; 2002: £56,000). The deferred compensation at 31 December 2004 was £599,000 (2003: £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 2004 as a result of these provisions is £115,000 (2003: £109,000; 2002: £nil) and is included within the charge disclosed above. The number of options to which variable accounting applies is approximately 908,000 (2003: 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 2004, a charge of £619,000 (2003: £241,000) was incurred and deferred compensation at 31 December 2004 was £1,905,000 (2003: £1,418,000).

As part of the consideration for Artisan, the Company granted approximately 90.4 million options over shares in ARM Holdings plc to employees of Artisan with substantially the same terms of those enjoyed when they were options over Artisan shares. As a result, a significant proportion of the options were already vested at acquisition. The intrinsic value of the unvested options was recorded as a reduction in shareholders' funds and a reduction in goodwill. This amount is then charged to the profit and loss account over the vesting period of the options. The total value deferred at 31 December 2004 was £9,579,000.

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

The ESOP was set up on 16 April 1998 to facilitate the recruitment, retention and motivation of employees. Under the Group's Long Term Incentive Plan, 5,003,724 shares could be awarded from shares already issued within the ESOP and QUEST. The market value of unearned shares at 31 December 2004 was £5,525,000.

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 £6,047,000 relating to 713,034 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 2004, 2003 or 2002.

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 or utilized to meet awards under the Company's LTIP.

During 2004, 8,046 shares (2003: 1,075,674) 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 March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on recognition and measurement guidance previously discussed under EITF Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-01"). The consensus clarified the meaning of other-than-temporary impairment and its application to debt and equity investments accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and other investments accounted for under the cost method. The recognition and measurement guidance for which the consensus was reached in March 2004 is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after 15 June 2004. In September 2004, the FASB issued a final FASB Staff Position that delays the effective date for the measurement and recognition guidance for all investments within the scope of EITF 03-01. The consensus reached in March 2004 also provided for certain disclosure requirements associated with cost method investments that were effective for fiscal years ending after 15 June 2004. The Company is evaluating the effect of adopting this recognition and measurement guidance.

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

In April 2004, the EITF issued Statement No. 03-06 "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share" ("EITF 03-06"). EITF 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 became effective during the quarter ended 30 June 2004, the adoption of which did not have an impact on the calculation of earnings per share of the Company.

In July 2004, the EITF issued a draft abstract for EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" ("EITF 04-08"). EITF 04-08 reflects the Task Force's tentative conclusion that contingently convertible debt should be included in diluted earnings per share computations regardless of whether the market price trigger has been met. If adopted, the consensus reached by the Task Force in this Issue will be effective for reporting periods ending after 15 December 2004. Prior period earnings per share amounts presented for comparative purposes would be required to be restated to conform to this consensus and the Company would be required to include the shares issuable upon the conversion of debt in the diluted earnings per share computation for all periods during which such debt is outstanding. The Company will evaluate the effect of adopting the recognition and measurement guidance when the final consensus is reached.

In December 2004, the FASB issued FAS 123(R), a revision to FAS 123, "Accounting for Stock-Based Compensation". The standard's effective date will apply to awards that are granted, modified, or settled in cash in interim or annual periods beginning after 15 June 2005. This standard eliminates the ability to account for share-based compensation using the intrinsic value-based method under APB Opinion No. 25, "Accounting for Stock Issued to Employees." It requires the Company to calculate equity-based compensation expense for stock options and employee stock purchase plan rights granted to employees based on the fair value of the equity instrument at the time of grant. Currently, the Company discloses the pro forma net income/(loss) and related pro forma income/(loss) per share information in accordance with FAS 123 and FAS 148, "Accounting for Stock-Based Compensation Costs-Transition and Disclosure." The Company will continue to evaluate the impact that this standard will have on its financial position and 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 2002 and 2003 have been, and those for the year ended 31 December 2004 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 paid royalties of £411,000 (2003: £nil, 2002: £nil) and made cross-license payments of £14,000 (2003: £453,000, 2002: £nil) to Superscape Group plc, a company in which Mike Inglis, an executive director of ARM, is a non-executive director. £nil (2003: £392,000) was owed to Superscape at 31 December 2004. Also during 2004, the Company received license fees of £209,000 (2003: £157,000, 2002: £nil) and support and maintenance income of £37,000 (2003: £nil, 2002: £nil) from CSR plc, a company in which John Scarisbrick, a non-executive director of ARM, became a non-executive director during the year. £nil was owed by CSR at 31 December 2004 (2003: £183,799).

3 Income taxes

Income before income tax is analyzed as follows:

	Year ended 31 December		
	2002 £000	2003 £000	**2004 £000**
United Kingdom	40,646	16,356	**34,569**
Foreign	4,776	5,603	**3,886**
	45,422	21,959	**38,455**

3 Income taxes continued

The provision for income taxes consisted of:

	Year ended 31 December		
	2002 £000	2003 £000	**2004 £000**
Current:			
United Kingdom	12,852	8,434	**10,619**
Foreign	1,791	1,447	**1,490**
Total current	14,643	9,881	**12,109**
Deferred:			
United Kingdom	(500)	(1,622)	**(1,171)**
Foreign	(358)	684	**(460)**
Total deferred	(858)	(938)	**(1,631)**
Total provision for income taxes	13,785	8,943	**10,478**

Included in the payable for income taxes is a current tax benefit of £826,000 (2003: £656,000; 2002: £814,000) and a deferred tax credit of £311,000 (2003: charge of £310,000; 2002: credit of £60,000) in relation to employee stock options. Such benefits are reflected as additional paid-in capital.

Also included in the provision for income taxes is a release of deferred tax liability in relation to acquired intangibles of £188,000 (2003: £nil; 2002: £nil).

Total income tax expense differs from the amounts computed by applying the UK statutory income tax rate of 30% for 2004, 2003 and 2002 to income before income tax as a result of the following:

	Year ended 31 December		
	2002 £000	2003 £000	**2004 £000**
UK statutory rate 30% (2003: 30%; 2002: 30%)	13,627	6,588	**11,537**
Permanent differences – other*	186	1,803	**177**
Differences in statutory rates of foreign countries	115	92	**231**
Other, net**	(143)	460	**(1,467)**
	13,785	8,943	**10,478**

*Permanent differences comprise permanent adjustments and the UK research and development tax credit.
**Other, net comprises prior year adjustments, timing differences and deferred tax adjustments.

Significant components of the deferred tax assets/(liabilities) are as follows:

	At 31 December		
	2002 £000	2003 £000	**2004 £000**
Fixed asset temporary differences	1,193	2,844	**5,669**
Temporary difference on available-for-sale securities	–	(446)	**(2,077)**
Non-deductible accruals and reserves	519	429	**1,592**
Amounts relating to intangible assets arising on acquisition	–	–	**(28,571)**
Losses carried forward	544	815	**13,825**
Total deferred tax assets/(liabilities)	2,256	3,642	**(9,562)**
Valuation allowance	(559)	(503)	**(254)**
Net deferred tax assets/(liabilities)	1,697	3,139	**(9,816)**

Disclosed on the balance sheet within:

	At 31 December		
	2002 £000	2003 £000	**2004 £000**
Assets	1,697	3,139	**2,529**
Liabilities	–	–	**(12,345)**
Net deferred tax assets/(liabilities)	1,697	3,139	**(9,816)**

Included in the amounts relating to intangible assets arising on acquisition is £22,150,000 relating to liabilities that are expected to accrue after more than one year.

3 Income taxes continued

UK income taxes have not been provided at 31 December 2004 on unremitted earnings of approximately £5,670,000 (2003: £6,891,000; 2002: £10,142,000) 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 £1,122,000 (2003: £347,000; 2002: £518,000). 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 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

	Year ended 31 December 2004		
	Income £	**Shares Number**	**Per share Amount**
Net income	**27,977,000**		
Basic EPS:			
Income available to common stockholders	**27,977,000**	**1,026,889,882**	**2.7p**
Effect of dilutive securities:			
Stock options		**22,878,223**	
Diluted EPS:			
Income available to common stockholders plus assumed conversion	**27,977,000**	**1,049,768,105**	**2.7p**

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, cash equivalents, short-term investments and marketable securities 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 13. At 31 December 2002, 2003 and 2004, no customers accounted for more than 10% of accounts receivable.

As of 31 December 2002 and 2003, the Company's cash, cash equivalents and short-term investments were deposited with major clearing banks and building societies in the UK and US in the form of money market deposits for varying periods of up to six months. At 31 December 2004, the Company's cash, cash equivalents, short-term investments and marketable securities were deposited with major clearing banks and building societies in the UK and US in the form of money market deposits and corporate bonds for varying periods of up to two years.

6 Acquisitions

Axys Design Automation Inc.
On 16 August 2004, the Company purchased the entire share capital of Axys Design Automation Inc., a US company, for a total consideration of $12.5 million (£6.9 million), comprising $11.6 million cash consideration and $0.9 million of related acquisition expenses. The purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed on the basis of their estimated fair values on the acquisition date. A further $3 million is potentially payable subject to the achievement of various post-acquisition financial milestones and will be accrued when payable. Axys is a provider of fast, accurate, integrated, processor and system modeling and simulation solutions and adds electronic system level expertise to ARM's design tools portfolio.

The operating results for Axys have been included in these financial statements for the period from 16 August 2004 to 31 December 2004. The acquisition was accounted for under SFAS 141.

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

	Fair value £000
Assets:	
Cash and cash equivalents	107
Accounts receivable, net	270
Other debtors	74
Deferred tax asset	710
Property and equipment, net	50
Total assets acquired	1,211
Liabilities:	
Accounts payable and other creditors	(17)
Accrued liabilities and deferred revenue	(729)
Total liabilities assumed	(746)
Net assets acquired	**465**

6 Acquisitions continued

The intangible assets recognized, apart from goodwill, represented contractual or other legal rights of Axys and those intangible assets of Axys that could be clearly identified. These intangibles were identified and valued through interviews and analysis of data provided by Axys concerning development projects, their stage of development, the time and resources needed to complete them, and if applicable, their expected income generating ability. There were no other contractual or other legal rights of Axys clearly identifiable by management, other than those identified below. The allocation of the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed was as follows:

	Useful estimated life (years)	£000
Fair value of net assets acquired		465
Intangible assets acquired:		
Developed technology	5	1,379
Customer relationships	5	425
Trademarks	5	96
In-process research and development (written-off on acquisition)		383
Deferred tax liability		(760)
Goodwill		4,914
Purchase price		6,902

The company's profit after tax for the year ended 31 December 2003 was £0.02 million and for the period from 1 January 2004 until acquisition was a loss of £0.9 million.

Artisan Components Inc.
On 23 December 2004, the Company acquired the entire share capital of Artisan Components Inc., a leading provider of physical IP components for the design and manufacture of complex system-on-chip ("SoC") integrated circuits. The acquisition enables the combined company to deliver one of the industry's broadest portfolios of SoC intellectual property to their extensive, combined customer base, with highly complementary sales channels combining ARM's channel to more than 140 silicon manufacturers with Artisan's channel to more than 2,000 companies. It better positions the combined company to benefit from growth opportunities across multiple industries as system design complexity increases, and strengthens the links between the key aspects of SoC development, enabling the combined company to deliver solutions that are further optimized for power and performance.

The operating results for Artisan have been included in these financial statements for the period from 23 December 2004 to 31 December 2004. The acquisition was accounted for under SFAS 141.

The total consideration paid was $926.9 million (£481.7 million), comprising cash of $235.4 million (£122.3 million), 324,399,411 ordinary shares in the Company with a fair value of $524.2 million (£272.4 million), approximately 90.4 million share options issued to existing Artisan employees with fair value of $151.9 million (£79.0 million) and related direct acquisition fees of $15.4 million (£8.0 million) including legal, valuation and accounting fees. The purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed on the basis of their estimated fair values on the acquisition date.

The shares issued on acquisition were valued in accordance with Emerging Issues Task Force Issue No. 99-12 ("EITF 99-12"), "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination". In accordance with EITF 99-12, the Company established the first date on which the number of the Company shares and the amount of other consideration became fixed as of 23 August 2004. Accordingly, the Company valued the transaction using the average closing price of the Company's ordinary shares two days before and after 23 August 2004, or $1.616 per share. The assumed options to acquire ordinary shares were valued using the Black-Scholes valuation model with volatility of between 80% and 94%, an average risk free interest rate of 4.5%, an estimated life of between zero and six years, and dividend yield of 0.7%.

6 Acquisitions continued

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

	Fair value £000
Assets:	
Cash, cash equivalents and marketable securities	82,567
Accounts receivable, net	15,078
Prepaid expenses and other assets	3,225
Deferred tax asset	15,446
Property and equipment, net	2,509
Total assets acquired	118,825
Liabilities:	
Accounts payable and other creditors	3,674
Accrued and other liabilities	13,245
Deferred revenue	6,545
Total liabilities assumed	23,464
Net assets acquired	**95,361**

The intangible assets recognized, apart from goodwill, represented contractual or other legal rights of Artisan and those intangible assets of Artisan that could be clearly identified. These intangibles were identified and valued through interviews and analysis of data provided by Artisan concerning development projects, their stage of development, the time and resources needed to complete them, and if applicable, their expected income generating ability. There were no other contractual or other legal rights of Artisan clearly identifiable by management, other than those identified below. The allocation of the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed was as follows:

	Useful estimated life (years)	£000
Fair value of net assets acquired		95,361
Intangible assets acquired:		
Developed technology	4 – 5	18,177
Patents/core technology	5 – 7	11,719
Existing agreements and customer relationships	3 – 8	36,354
Trademarks/tradenames	4 – 5	2,500
Order backlog	0 – 1	1,354
In-process research and development (written-off on acquisition)		3,229
Deferred stock-based compensation		9,579
Deferred tax liability		(28,042)
Goodwill		331,432
Purchase price		481,663

Developed technology Developed technology of £18.2 million and patents and core technology of £11.7 million included intellectual property components for use in SoC integrated circuits and consisted of the following: embedded memory, standard cell, input/output components, and analog and mixed-signal products. In addition, developed technology included a combination of processes, patents, patent applications, core modular architecture and trade secrets that are the buildings blocks of the technology. At the date of acquisition, the developed technology was complete and had reached technological feasibility. Any costs incurred in the future will relate to the ongoing maintenance of the developed technology and will be expensed as incurred. To estimate the fair value of the developed technology, an income approach was used with a discount rate of 14% for existing technology and 16% for patents and core technology, which included an analysis of future cash flows and the risks associated with achieving such cash flows. All developed technologies are being amortized over the estimated useful lives of four to five years.

Existing agreements and customer relationships and order backlog The customer base of £36.4 million and order backlog of £1.4 million represented the fair value of existing customer relationships and contracts, royalty arrangements, and support and maintenance agreements. To estimate the fair value of the customer base and order backlog, a cost approach (replacement value) was used. The customer base and order backlog are being amortized over their estimated useful lives of three to six years for customer base and one year for order backlog.

Trademarks and tradenames The fair value assigned to trademarks and tradenames, including the company name Artisan, was estimated using the income approach, which discounts the present value of attributable cash flows at a discount rate of 16%.

6 Acquisitions continued

In-process research and development Development projects that had reached technological feasibility were classified as developed technology and the value assigned to developed technology was capitalized. Expensed in-process research and development of £3.2 million reflected certain research projects that had not yet reached technological feasibility and commercial viability or had no alternative future use at the time of the acquisition. The fair value assigned to in-process research and development was estimated based on the percentage of completion of each project using the income approach, which discounts to present value the cash flows attributable to the technology once it has reached technological feasibility using a discount rate of 19%. In-process research and development has been written-off immediately to the income statement.

Goodwill of £331.4 million represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. As stated, the acquisition enables the combined company to deliver one of the industry's broadest portfolios of SoC intellectual property to their extensive, combined customer base and it better positions the combined company to benefit from growth opportunities across multiple industries as system design complexity increases. These, combined with the ability to hire the entire Artisan work force, were significant contributing factors to the establishment of the purchase price, resulting in the recognition of a significant amount of goodwill. In accordance with SFAS 142, the Company is not amortizing goodwill relating to the acquisition. It is being carried at cost and the Company will test it for impairment annually and whenever events indicate that an impairment may have occurred.

The unaudited pro forma results of the Company for the current year, had the acquisition occurred on 1 January 2004, and for the prior year, had the acquisition occurred on 1 January 2003, would have been:

	2003 Unaudited £000	**2004 Unaudited £000**
Revenues	173,277	**197,852**
Income from operations	3,730	**15,973**
Net income	1,650	**16,365**
Diluted earnings per ordinary share	0.1p	**1.2p**

Net income has been reduced in these pro forma results in relation to reduced interest income as a result of the cash portion of the acquisition consideration, amortization of intangibles acquired and amortization of deferred compensation.

7 Investments and marketable securities

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 2000, the Company invested £688,000 in Cambridge Silicon Radio Holdings Limited, an unlisted investment. In February 2004, the company (now CSR plc) became a listed investment. The aggregate fair value of listed investments at 31 December 2004 was £10,262,000 (2003: £4,139,000). In 2004, the Company invested £112,000 in Zeevo Inc. and £50,000 in Reciva Limited, both unlisted companies.

Impairments during 2004 against unlisted investments held at the year end amounted to £nil (2003: £622,000; 2002: £826,000) and against listed investments held at the year end amounted to £nil (2003: £938,000).

At 31 December 2004, the Company had £21,511,000 (2003: £nil) and £5,438,000 (2003: £nil) of short- and long-term marketable securities respectively. These represent both the fair market value and the amortized cost of the securities.

8 Property and equipment

	At 31 December	
	2003 £000	**2004 £000**
Owned buildings	190	**190**
Leasehold improvements	20,345	**21,405**
Computers	11,168	**12,291**
Software	33,106	**35,787**
Fixtures, fittings and motor vehicles	3,202	**3,215**
	68,011	**72,888**
Less: accumulated depreciation	(51,428)	**(58,771)**
Property and equipment, net	16,583	**14,117**

Depreciation charged to income for the years ended 31 December 2002, 2003 and 2004 was £12,463,000, £12,908,000 and £9,927,000 respectively.

9 Intangible assets

	Goodwill £000	Patents £000	Licenses £000	Developed technology £000	Existing agreements and customer relationships £000	Core technology £000	Trademarks £000	Order backlog £000	Total £000
Cost									
At 1 January 2004	7,672	8,196	4,704	167	135	–	–	–	20,874
Additions (Axys)	4,914	–	–	1,379	425	–	96	–	6,814
Additions (Artisan)	331,432	–	–	18,177	36,354	11,719	2,500	1,354	401,536
Other additions	–	–	160	–	–	–	–	–	160
Exchange differences	(282)	–	–	(79)	(25)	–	(6)	–	(392)
At 31 December 2004	**343,736**	**8,196**	**4,864**	**19,644**	**36,889**	**11,719**	**2,590**	**1,354**	**428,992**
Aggregate amortization									
At 1 January 2004	3,320	3,740	3,704	14	28	–	–	–	10,806
Charge for the year	–	2,137	484	234	240	51	21	30	3,197
Exchange differences	–	–	–	(4)	(1)	–	–	–	(5)
At 31 December 2004	**3,320**	**5,877**	**4,188**	**244**	**267**	**51**	**21**	**30**	**13,998**
Net book value									
At 31 December 2004	**340,416**	**2,319**	**676**	**19,400**	**36,622**	**11,668**	**2,569**	**1,324**	**414,994**
At 31 December 2003	4,352	4,456	1,000	153	107	–	–	–	10,068

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 four to five years, existing agreements and customer relationships over two to six years, core technology over five years, trademarks over four years and order backlog over one year, 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
2005	18,388
2006	14,681
2007	14,454
2008	13,668
2009	8,205

10 Accrued liabilities

Included within accrued liabilities at 31 December 2004 are £14.3 million (2003: £nil) of acquisition-related expenses, £nil (2003: £6.4 million) relating to the Herodion settlement provision, £4.4 million (2003: £nil) provision for staff costs and £2.8 million (2003: £2.1 million) representing the fair value of embedded derivatives.

11 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 as are those options assumed on the acquisition of Artisan.

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 Sheme, 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. Various options to directors under the Unapproved Scheme have certain performance criteria attached, which if met are exercisable after three years, otherwise they will become exercisable after seven years.

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.

Upon the acquisition of Artisan in 2004, the Company assumed the share schemes of Artisan existing at acquisition. The schemes remained substantially the same as prior to the acquisition, other than the options became options to purchase shares in ARM Holdings plc instead of Artisan Components Inc. The number and value of options were amended in line with the conversion ratio as detailed in the merger agreement. The schemes assumed were the "1993 Plan", the "1997 Plan", the "2000 Plan", the "2003 Plan", the "Director Plan", the "Executive Plan" and the "ND00 Plan".

Under each plan, there are multiple vesting templates and vesting periods. The majority of the options were already vested upon acquisition, and the most common template was 25% vesting after one year, and then 6.25% vesting each quarter thereafter, until 100% vest after four years. Some options vest on a monthly basis, and some vest over five years. All options lapse ten years from the date of grant.

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 further savings-related option schemes in each year up to and including 2004 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 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
Granted in year	16,934,076	1.226
Assumed on acquisition of Artisan	90,414,815	0.434
Lapsed in year	(5,770,196)	1.914
Exercised in year	(3,049,960)	0.431
Balances, 31 December 2004	**164,019,815**	**0.870**

The weighted average grant-date fair value of options granted during 2004 was £0.74 (2003: £0.28; 2002: £1.43)

The weighted average exercise price of options exercisable at 31 December 2004 was £1.00 (31 December 2003: £2.45; 31 December 2002: £1.71).

11 Shareholders' equity continued

The following options over ordinary shares were in existence at 31 December 2004:

	Options outstanding			Options exercisable	
Exercise price	Number outstanding	Weighted average remaining life (years)	Weighted average exercise price (£)	Number outstanding	Weighted average exercise price (£)
0.02 - 0.30	38,594,706	6.11	0.24	32,431,262	0.24
0.35 - 0.45	34,851,183	5.41	0.43	8,493,287	0.42
0.46 - 0.60	31,888,046	7.43	0.52	10,605,230	0.50
0.61 - 1.224	27,572,570	7.42	0.86	7,494,872	1.16
1.25 - 7.738	31,113,310	4.67	2.51	10,600,077	4.19
Total	164,019,815	6.17	0.87	69,624,728	1.00

Under the Company's Long Term Incentive Plan, a further 5,003,724 (2003: 2,572,646; 2002: nil) 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 QUEST and ESOP.

12 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 2004, are as follows:

Years ending 31 December	Operating leases £000
2005	6,183
2006	4,711
2007	4,030
2008	3,435
2009	2,388
Thereafter	13,492
Total minimum lease payments	34,239

Rental expense under operating leases totalled £5,199,000, £8,169,000 and £12,627,000 for the years ended 31 December 2002, 2003 and 2004 respectively.

In May 2002, Nazomi Communications Inc. filed suit against ARM alleging wilful infringement of Nazomi's US patent No. 6,332,215. ARM answered Nazomi's complaint in July 2002, denying infringement. ARM moved for summary judgement and a ruling that the accused technology does not infringe. In September 2003, the United States District Court of Northern California granted ARM's motion, holding that the accused technology does not infringe Nazomi's patent. Nazomi appealed the District Court's ruling. On 7 September 2004, the Court of Appeals for the Federal Circuit heard the appeal and the decision of the Court is expected in the first half of 2005. Based on legal advice received to date, ARM has no cause to believe that the effect of the original ruling by the District Court will not be upheld.

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. The provision is made if both of the following conditions are met: (i) information available prior to the issuance of the financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements; and (ii) the amount of the liability can be reasonably estimated. Any such provision is based upon the directors' estimate of the expected costs of any such claim.

12 Commitments and contingencies continued

The total provision for such guarantees was £0.5 million on 31 December 2004, and a table showing the movement of the provision during the year is as follows:

	At 1 January 2004 £000	Provided in the year on new claims £000	Released in the year £000	Utilized in the year through cash payments £000	At 31 December 2004 £000
Indemnification provision	**1,700**	1,130	(780)	(1,530)	520

The fair value of the guarantees approximates to book value due to the expected short-term nature of the provision.

At 31 December 2004, ARM had provided in aggregate £1.3 million (2003: £2.5 million) in relation to the above legal matters, being the expected future costs to be incurred. In addition, the Company had provided £6.4 million at 31 December 2003 (2004: £nil) in relation to the Herodion settlement.

At 31 December 2004, the Company had outstanding purchase commitments of £1,179,000 (2003: £1,365,000).

13 Geographic and segment information

The directors are of the opinion that the Company had only one class of business during 2004. Following the acquisition of Artisan Components Inc., the directors are considering whether the business is going to be re-organised, how it will be monitored internally and whether different reportable segments will be formed.

Because the acquisition of Artisan was completed so close to the year end, the Company's consolidated income statement does not include any material trading results in respect of Artisan (the Physical IP group) in 2004. Total assets of £637,937,000 at 31 December 2004 are split: ARM (Cores) £133,144,000 and Physical IP £504,793,000.

The following analysis is of revenues by geographic segment and origin and long-lived assets (excluding intangible assets and long-term deferred taxes) by companies in each territory:

	Year ended 31 December		
	2002 £000	2003 £000	**2004 £000**
Revenues (by market destination):			
Europe	26,731	23,118	**23,837**
US	67,086	65,402	**77,457**
Japan	38,295	24,135	**32,754**
Asia Pacific excluding Japan	18,810	15,415	**18,849**
Total revenues	150,922	128,070	**152,897**

The Company's exports from the UK were £135,713,000, £115,072,000 and £138,078,000 for the years ended 31 December 2002, 2003 and 2004 respectively.

	Year ended 31 December		
	2002 £000	2003 £000	**2004 £000**
Revenues (by origin):			
Europe	137,747	118,885	**141,974**
US	7,288	4,893	**6,384**
Asia Pacific	5,887	4,292	**4,539**
Total revenues	150,922	128,070	**152,897**

	At 31 December	
	2003 £000	**2004 £000**
Long-lived assets:		
Europe	21,116	**22,730**
US	1,533	**3,495**
Asia Pacific	180	**127**
Total long-lived assets	22,829	**26,352**

In 2004, 2003 and 2002 no single customer accounted for more than 10% of total revenues.

14 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.

Marketable securities The carrying amount approximates fair value because these instruments are marked-to-market.

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:

	At 31 December			
	2003		**2004**	
	Carrying amount £000	Fair value £000	**Carrying amount £000**	**Fair value £000**
Cash and cash equivalents	130,722	130,722	**110,561**	**110,561**
Short-term investments	29,064	29,064	**5,307**	**5,307**
Marketable securities	–	–	**26,949**	**26,949**
Accounts receivable	17,320	17,320	**34,347**	**34,347**
Foreign currency contracts	2,015	2,015	**1,674**	**1,674**
Embedded derivatives	(2,091)	(2,091)	**(2,823)**	**(2,823)**

15 Post balance sheet events

At the 2005 Annual General Meeting of the Company on 25 April 2005, a final dividend of 0.42 pence per share (total cost £5,673,000) will be proposed in respect of the 2004 financial year, and if approved will be paid on 6 May 2005 to shareholders on the register at 1 April 2005.

Report of independent registered public accounting firm/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 2004 and 2003 and the results of their operations and their cash flows for the years ended 31 December 2004, 2003 and 2002 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 the standards of the Public Company Accounting Oversight Board (United States), 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 Chartered Accountants
Cambridge, England
4 March 2005

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

20-22 rue Louis Armand
75015 Paris
France
Tel: +33 1 45 57 43 48
Fax: +33 1 44 25 26 00

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
Lehrer-Wirth-Strasse 4
D-81829 Munich
Germany
Tel: +49 89 928 615-0
Fax: +49 89 928 615-19

Kaiserstrasse 100, TPH III C
D-52134 Herzogenrath
Germany
Tel: +49 24 079 086-0
Fax: +49 24 079 086-11

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

ARM, Inc.
141 Caspian Court
Sunnyvale, CA 94089-1013
United States
Tel: +1 408 734 5600
Fax: +1 408 734 5050

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

125 Edinburgh Drive South
Suite 210, MacGregor Park
Cary, NC 27511-6487
United States
Tel: +1 919 465 3660
Fax: +1 919 465 3667

5 East Street
Franklin, MA 02038
United States
Tel: +1 508 520 1905
Fax: +1 508 520 1907

1 Jenner Drive, Suite 260
Irvine, CA 92618
United States
Tel: +1 949 341 1900
Fax: +1 949 341 1901

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

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

264B North Broadway
Suite 204A
Salem, NH 03079
United States
Tel: +1 603 896 6322
Fax: +1 603 896 6324

5580 Morehouse Drive
San Diego, CA 92121
United States
Tel: +1 858 455 7570
Fax: +1 858 457 5578

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

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

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

ARM Consulting (Shanghai) Co. Ltd
Room 809, Building B
Far East International Plaza
No. 317 XianXia Road
Shanghai 200051
PR China
Tel: +86 21 62351296
Fax: +86 21 62351207

Room 905, Silver Tech Tower
No. 38 Hai Dian Avenue
Hai Dian District
Beijing 100080
PR China
Tel: +86 10 82603570
Fax: +86 10 82603573

ARM Embedded Solutions Pvt. Limited
Adarsh Opus, 3rd Floor
1 Campbell Road, Austin Town
Bangalore 560-047
India
Tel: +91 80 5138 4000
Fax: +91 80 5112 7403

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ARM

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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