ARM Holdings plc

ANNUAL REPORT AND ACCOUNTS 1998

ARM designs and licenses high performance, low cost, power efficient RISC microprocessors, related technology and software in order to enhance performance, cost effectiveness and power efficiency in an extensive range of applications.

Our mission is to establish the ARM® architecture as the standard embedded RISC processor for use in a wide range of high volume applications in the embedded, portable and consumer multimedia markets.

CONTENTS

For the benefit of UK and US based shareholders and customers of ARM, the financial statements are presented in both UK and US formats in separate sections of the report. The other sections are common to both sets of financial statements.

The "Company" and "group" refer to ARM Holdings plc and its subsidiaries including ARM Limited, ARM, INC., ARM KK, and ARM Korea Limited.

ENABLING INNOVATION

Today the ARM® architecture is enabling the next generation of emerging applications such as smart cell phones, advanced gaming, PDA's and embedded solutions.

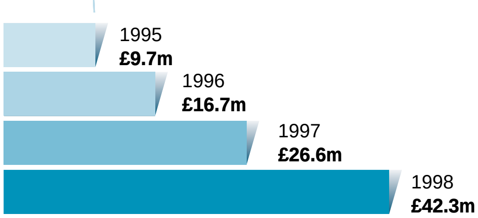
ARM® solutions are process portable, allow integration with larger system-on-chip designs and are supported by a wide range of models, tools, operating systems and application software from our network of software, EDA and design partners.

Our global network of offices gives us the local presence to develop and expand the ARM partnership business model.

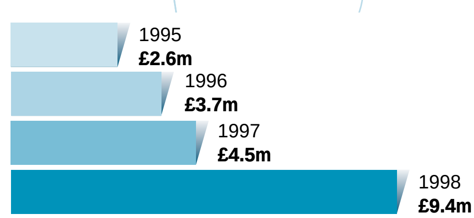
FINANCIAL HIGHLIGHTS

- Revenues up **59%** to **£42.3 million** (1997: £26.6 million)
- Profit before taxation up **108%** to **£9.4 million** (1997: £4.5 million)
- **Doubling** of development system sales and **strong** unit shipment growth

Revenues



Income Before Income Tax (US GAAP)



CHAIRMAN AND CHIEF EXECUTIVE'S REVIEW

1998 was a successful year for ARM, demonstrating the group's underlying financial strength. The development of our business model based on global partnership should provide a robust platform for further development and growth.

Following the successful listing of the Company on the London Stock Exchange ("ARM") and the Nasdaq Stock Market ("ARMHY") in April of last year, I am pleased to present the annual results in our first year as a public company.

Licensee Development

Despite a challenging year in the semiconductor industry and economic difficulties in the Far East, we were able to sign six new ARM7TDMI® licensees, three of whom were Japanese, namely Matsushita, Seiko Epson and Toshiba. The other new licensees included Hewlett Packard and two licensees who wish to remain confidential for the moment, one of them being headquartered in the United States and the other in Europe. The ARM7TDMI® remains our most popular product and the key entry-point to our technology.

We concluded our first agreement with Intel Corporation, who took a license for the ARMv4 architecture enabling them to supply and develop the StrongARM® range of products following the acquisition of Digital Semiconductor.

There was much interest in the ARM9® family of products, with four ARM9® family licenses signed during the year.

Growth in Unit Shipments

1998 saw growth in unit shipments of ARM® microprocessors from less than ten million units in 1997 to just over 50 million units in 1998. A large number of new products using the ARM® microprocessor were launched in diverse markets including digital mobile phones, games machines, set-top boxes, networking products, a Windows CE based sub-notebook and a range of demonstrators of future technology. At the end of 1998 fourteen of our semiconductor partners were shipping products compared to eight in 1997.

Product Development

Our next generation high performance ARM10™Thumb® microprocessor family was announced in October at the Embedded Processor Forum. Designed to deliver 400 MIPS at 300 MHz, the ARM10™Thumb® family is optimised to enable reduced system complexity, increased flexibility and low cost on multiple fabrication processes.

We also announced that National Semiconductor was our first licensee for the ARM7TDMI-S®, a synthesisable version of the ARM7TDMI®. We are currently in the process of developing a synthesisable version of the ARM9® and further architectural extensions.

In order to accelerate product development, during the year, we reallocated engineering resource from consulting to product development and this effectively limited growth in our consulting business. However, so as to be able to satisfy the growing demand for ARM® based 'system on chip' (SoC) designs, we launched the ARM Technology Access Program (ATAP). By joining the program, design houses who pass our strict qualification process are able to access ARM® technologies to enable them to undertake ARM® based designs for third parties. The first announced ATAP partner is the Cadence SoC design centre in Livingston, Scotland.

ARM Involvement in Industry Standardisation

The year saw a number of interesting developments including the creation of the Symbian joint venture between Nokia, Ericsson, Motorola and Psion and the

CHAIRMAN AND CHIEF EXECUTIVE'S REVIEW

The future is full of potential. With the energy, ability and commitment of our staff we will pursue the opportunities for growth and expansion with enthusiasm

creation of the Bluetooth program, an initiative from Ericsson, Intel, IBM, Nokia and Toshiba, devised to revolutionise wireless connectivity for business and personal mobile devices. Microsoft has continued its investment in Windows CE with the introduction of its Handheld PC Professional Edition, which is also fully supported on the ARM® architecture. The development of formalised intellectual property exchange in the semiconductor and systems world moved a step nearer with the announcement of the Virtual Component Exchange (VCX), whose mission is to establish a structured marketplace for buying and selling semiconductor intellectual property.

ARM is a member of its steering group, and is also a founding board member of the Virtual Socket Interface (VSI) Alliance, an industry collaboration set up to establish interconnectivity standards between intellectual property components in the semiconductor industry to enable the move to System on Chip solutions.

Employees and Facilities

As an intellectual property company, people are the key asset to the success of our business. I cannot stress too strongly how highly we value the creativity, loyalty, dedication and skills of our staff. I would like to take this opportunity to record my appreciation of their contribution to our progress.

Staff numbers rose to 354 at the end of 1998 from 274 at the end of 1997. We moved into larger offices in Tokyo, Japan and Maidenhead, UK and expanded our offices in Los Gatos, California and Austin, Texas. In November 1998, we also entered into agreements to lease a 45,000 square foot purpose built building on the Peterhouse Technology Park next to our existing offices in Cambridge, and a 17,000 square foot new office in

Los Gatos, California. In addition, we opened new offices in Paris, France, and Westborough near Boston, USA. These additions should give us the capacity to accommodate over 650 staff worldwide and should be adequate for our medium-term needs.

Board Structure

To strengthen the board, three independent non executive directors were appointed during 1998. The board appointments were Peter Cawdron and Larry Tesler in March, and Doug Dunn OBE in December. In addition, two executive directors, Jonathan Brooks, Chief Financial Officer, and Jamie Urquhart, Chief Operating Officer, were appointed to the board in March. The board representation of our two largest founding shareholders, Apple Computer Inc and Acorn Group plc, was reduced from two seats each prior to the IPO to one seat each and on January 15, 1999, Apple's representative, Gary Wipfler, resigned. Since then, Apple has sold a further part of its shareholding and at the time of writing holds a little over 15% of the Company's shares.

Outlook

Despite the general economic uncertainty, 1999 has started well with four further license agreements reached: one new agreement for the ARM7TDMI® and three agreements with existing partners for the ARM9® family. We plan a year of continued growth and progress in all areas.

Robin Saxby

Chairman and Chief Executive

March 5, 1999

The Sunday Times - Inside Track - Paul Kavanagh

StrongARM has world in its hand

SHARES in ARM Holdings, which came to the market in April, have traded at between 715p and £13.25. At Friday's closing price of 850p they are now worth a long-term investment.

ARM designs microprocessors for use in a wide range of electronic applications. It's key advantage is that they offer the high performance required by manufacturers at low cost. They are also power efficient.

The microprocessors are particularly attractive to the developing industries of partable communications and the consumer mulit-media market, both of which expected to witness explosive growth during the next few years. ARM generates most of its revenue from licensing and royalties. The benefit of increased volumes as the industry develops should boost profits.

The Telegraph

WEDNESDAY, FEBRUARY 3 1999

ARM's strength passes the test

ARM Holdings has been an unsung Stock Market phenomenon since its flotation last April. Helped by enthusiasm for all things high tech, the microprocessor company's shares have rocketed from 750p to £18.25.

Yesterday's full-year results helped justify the hyped. Pre-tax profits jumped 108pc to £9.4m, with sales up 59pc to £42.3m.

One of the keys to the company's success is that the management has realised the importance of cost-effectiveness and energy efficiency in microprocessors. ARM has come up with microprocessors which use just 3pc of the power needed by rivals and this has gone down particularly well in the mobile phones industry - where battery life is crucial. About 70pc of group sales went to phone companies last year as the sector boomed.

ELECTRONICS WEEKLY

Profits up in ARM's first trading year

Risc specialist ARM Holdings has marked a strong start to 1999 with excellent maiden full-year results and the announcement of two new contracts.

Pre-tax profit rose 108% to £9.4m on sales up 59% at £42.3m on the back of design wins and rising royalty income.

The company also announced that Toshiba has licensed its ARM7TDM1 microprocessor core for use with embedded DRAM, that it has formally endorsed US IP vendor Palmchip's core frame architecture for system-on-chip (SoC) design. The Toshiba deal puts ARM in a strong position as SoC systems are combined with embedded DRAM to develop voice recognition and advanced communications products. The second agreement is a further step in its relationship with Palmchip - where it is a minority shareholder - to attack the hard disk drive market.

Introducing the results, Robin Saxby, ARM's chairman, and CEO said: "During the year, volume shipment of products based on the ARM architecture increased from less than 10 million units to an estimated 50 million."

THE INDEPENDENT

Upbeat prospects for chip designer

BY PETER THAL LARSEN

INTERNET STOCKS may be the flavour of the moment. But in recent months canny investors have been ignoring the hype and paying more attention to ARM, the British computer chip designer that is taking the semi-conductor world by storm.

Yesterday shares in ARM surged to a new high of 1,825p, up 100p, as the Cambridge-based group beat analysts' forecasts with a 59 per cent jump in revenues to £42.3m for the year to December. Pre-tax profits more than doubled to £9.4m.

The shares have trebled in value since ARM floated on the London and Nasdaq exchanges last April, taking the company's market value close to £900m.

Financial Times 11th February 1999

Cambridge awaits its first £1bn high-tech company

ARM, a chip designer, has seen its shares soar since its flotation, writes **Paul Taylor**

If technology shares continue to climb, Silicon Fen - Britain's high-technology "capital" around Cambridge - may soon boast its first company with a £1bn market capitalisation.

Enthusiasm for shares in ARM, a chip designer which was floated 11 months ago at 574p, sent them up last week to £19.85, valuing the group at £970m, though they have since slipped to £19.425p

US Securities Law Matters

ARM is required to comply with various U.S. securities laws and regulations, because it has American Depositary Shares registered with the U.S. Securities and Exchange Commission ("SEC") which are traded in the U.S. on the Nasdaq Stock Market.

SEC Filings. As a foreign private issuer in the U.S., the Company is required to make certain filings with the SEC, including periodic filings on Form 6-K and an annual report on Form 20-F.

The Company is required to file with the SEC by means of Form 6-K any information that ARM makes or is required to make public pursuant to the laws of the U.K., or is required to file with the London Stock Exchange, or distributes or is required to distribute to its shareholders.

Form 20-F is similar to the annual Form 10-K filing required of U.S. public companies, except that Form 20-F makes allowances for the differences in legal and regulatory obligations applicable to non-US companies. The filing includes a general introduction to ARM, and sections discussing, among other items, a description of its business, its property, its principal shareholders, the nature of the trading markets, taxation issues, information regarding its directors and officers, as well as risk factors regarding the Company.

The Company currently plans to file its first Form 20-F with the SEC in March 1999. A copy of such Form 20-F may be obtained without charge by contacting "Investor Relations" at ARM's Cambridge office listed in the back of this Annual Report.

Special Note on Forward-Looking Statements. ARM is also subject to various US securities laws and regulations relating to the disclosure of information. In particular, the Private Securities Litigation Reform Act of 1995, which became effective in the United States as of January 1, 1996 ("Securities Litigation Reform Act"), applies to the Company and its disclosure of information and provides that the Company can be exempt from liability for making forward-looking statements if certain cautionary language is included along with such statements. This Annual Report contains certain "forward-looking statements" (as such term is defined in Section 27A of the U.S. Securities Act of 1993, as amended) that are based on the beliefs of the Company's management, as well as assumptions made by and information currently available to the Company's management. Such forward-looking statements are subject to the safe harbor created by the Securities Litigation Reform Act. When used in this document, the words "anticipate", "believe", "estimate", "expect", "intend", and similar expressions, as they relate to the Company or its management, are intended to identify such forward-looking statements. Such statements reflect the current views of the Company or its management with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, the Company's actual results, performance or achievements in fiscal 1999 and beyond could differ materially from those expressed in, or implied by, any such forward-looking statements. Factors that could cause or contribute to such material differences include, but are not limited to, those discussed below in Management's Discussion and Analysis under the heading "Risk Factors", as well as those discussed elsewhere in this Annual Report. The inclusion of such forward-looking information should not be regarded as a representation by the Company or any other person that the future events, plans or expectations contemplated by the Company will be achieved. The Company undertakes no obligation to release publicly any updates or revisions to any such forward-looking statements that may reflect events or circumstances occurring after the date of this Annual Report.

Electronic Filings. The SEC maintains a World Wide Web site located at http://www.sec.gov that contains a searchable database of filings, reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. Foreign private issuers such as ARM are not currently required to file electronically with the SEC but may choose to do so.

Annual General Meeting of Shareholders. The 1999 Annual General Meeting of ARM Holdings plc will be held at the offices of Linklaters & Alliance, 1 Silk Street, London, EC2Y 8HQ, England on April 20, 1999.

Ordinary Shares. The Company's ordinary shares were listed on the London Stock Exchange in April 1998 under the symbol ARM at a price of £5.75. The Company's ordinary shares were listed on the Nasdaq Stock Market in the US in the form of American Depositary Shares ("ADSs"), evidenced by American Depositary Receipts under the symbol ARMHY at a price of $29.17. One of the Company's ADSs represents 3 ordinary shares.

Share Price Information

	London Stock Exchange (in G.B. pounds)		Nasdaq (in U.S. dollars)	
Quarter Ended	High	Low	High	Low
June 30, 1998	12.35	7.00	61.25	35.00
September 30, 1998	13.63	8.25	63.75	44.00
December 31, 1998	13.28	7.55	67.38	40.88

CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH US GAAP

The following selected financial data should be read in conjunction with, and is qualified in its entirety, by reference to the financial statements of ARM Holdings plc, expressed in G.B. pounds, set forth on pages 10 to 29 of this report.

Selected Consolidated Financial Data - US GAAP

(in thousands)	1994 (unaudited)	1995	1996	1997	1998
Revenues	£6,610	£9,674	£16,694	£26,580	£42,268
Cost of revenues	527	1,032	4,095	6,685	8,316
Operating expenses	3,711	6,304	8,800	15,927	26,315
Income from operations	2,372	2,338	3,799	3,968	7,637
Provision against investment	–	–	(199)	–	–
Interest and similar income, net	82	283	72	604	1,865
Share of loss of equity affiliate	–	–	–	(31)	(71)
Minority interest	–	–	–	(15)	(8)
Income before income tax	2,454	2,621	3,672	4,526	9,423
Provision for income taxes	592	757	1,029	1,615	3,371
Net income	1,862	1,864	2,643	2,911	6,052
Earnings per common share (assuming dilution)	4.7p	4.7p	6.7p	7.1p	7.8p
IPO dividend per common share	–	–	–	–	9.97p
Research and development as a percentage of revenues	14.5%	23.2%	17.6%	23.1%	27.5%
Capital expenditure	£1,024	£1,147	£1,759	£4,033	£6,402
Cash and cash equivalents	£4,208	£3,627	£10,115	£7,405	£39,591
Shareholders' equity	£4,553	£6,414	£9,011	£12,454	£48,280
Total assets	£8,564	£10,764	£16,011	£21,961	£60,580
Employees at year end	91	129	162	274	354

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS US FORMAT

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto. The matters addressed in this Management Discussion and Analysis of Financial Condition and Results of Operations, with the exception of the historical information presented, contain forward-looking statements involving risks and uncertainties.

Overview

ARM designs high performance, low-cost, power-efficient RISC microprocessors and related technology and software, and sells development systems, to leading international electronics companies, which in turn manufacture, market and sell microprocessors, application specific integrated circuits (ASICs) and application specific standard products (ASSPs) based on ARM's 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 systems designers. ARM has developed an innovative, intellectual property-centered and market-driven business model in which it neither manufactures nor sells the products incorporating ARM® technology, but concentrates on the research and development, design and support of ARM® architecture and supporting development tools and software.

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

	Year ended December 31		
	1996	1997	1998
Revenues			
Product revenues	77.2%	75.8%	83.2%
Service revenues	22.8%	24.2%	16.8%
Total revenues	100.0%	100.0%	100.0%
Cost of revenues			
Product costs	10.8%	13.3%	9.3%
Service costs	13.7%	11.8%	10.3%
Total cost of revenues	24.5%	25.1%	19.6%
Gross profit	75.5%	74.9%	80.4%
Operating expenses			
Research and development	17.6%	23.1%	27.5%
Sales and marketing	20.0%	20.2%	18.0%
General and administration	15.1%	16.6%	16.8%
Total operating expenses	52.7%	59.9%	62.3%
Income from operations	22.8%	15.0%	18.1%
Provision against investment	(1.2%)	–	–
Interest and similar income, net	0.4%	2.3%	4.4%
Share of loss of equity affiliate	–	(0.1%)	(0.2%)
Minority interest	–	(0.1%)	–
Income before income tax	22.0%	17.1%	22.3%
Provision for income taxes	6.2%	6.1%	8.0%
Net income	15.8%	11.0%	14.3%

Product Revenues

Product revenues consist of license fees, sales of development systems and royalties. Product revenues for 1996, 1997 and 1998 were £12.9 million, £20.1 million and £35.2 million, representing 77%, 76% and 83% of total revenues respectively.

License revenues as a percentage of total revenues decreased from approximately 70% in 1996 to approximately 60% in 1997 but increased to approximately 64% in 1998. The ARM7TDMI® remained the key entry point to the Company's technology and the main product licensed during 1996, 1997 and 1998. It accounted for 76% of license revenues in 1996, 55% of license revenues in 1997 and 63% of license revenues in 1998.

Six new licensees were signed in 1998 bringing the total number of semiconductor partners to 32. However, with the purchase of Symbios Logic by LSI Logic and the consolidation of LG Semicon and Hyundai Electronics, the total number of semiconductor partners stood at 30 at the end of 1998. During the year, the Company sold seven further licenses to existing licensees, four of which were ARM9® related. This brought the number of licensees of the ARM9® family to seven at the end of 1998. Four additional licensees joined the Company's RTOS program during the year bringing the total number of participants to 14. During the year, license revenue was also generated from the newly formed Windows CE Consortium, a similar arrangement to the RTOS program, and at December 31, 1998 Cirrus Logic, Intel, LG Semicon, and Texas Instruments were members of the Consortium.

Revenues from the sale of development systems increased from £0.8 million in 1996 to £2.2 million in 1997 and £4.4 million in 1998 representing 5%, 8% and 10% of total revenues in 1996, 1997 and 1998 respectively. The increase reflected the growing number of engineers working on products using the ARM® architecture. A number of new development system products were also introduced during the year, including a new debug tool called MultiICE™ and a low cost evaluation board.

Royalties are either set as a percentage of the licensee's net sales price per chip or, less frequently, as a fixed amount. Royalties increased from £0.5 million in 1996 to £2.2 million in 1997 and £3.6 million in 1998 representing 3%, 8% and 8% of total revenues in 1996, 1997 and 1998 respectively. During 1998, the Company ceased making accruals for royalties relating to the current period, so bringing it into line with industry practice. With the significant increase in volume shipments from less than 10 million units in 1997 to just over 50 million units in 1998, the Company expects royalty revenues to continue to grow although they may be subject to significant fluctuations.

Service Revenues

Service revenues consist of design consulting services and revenues from support, maintenance and training. Service revenues increased from £3.8 million in 1996 to £6.4 million in 1997 and £7.1 million in 1998 representing 23%, 24% and 17% of total revenues in 1996, 1997 and 1998 respectively. This growth was largely driven by higher revenues from support, maintenance and training which increased from £1.3 million in 1996 to £2.8 million in 1997 and £4.1 million in 1998 reflecting the increase in the number of new licensees during this period as well as growth in training opportunities. Consulting revenues increased from £2.5 million in 1996 to £3.7 million in 1997 but decreased in 1998 to £3.0 million as the Company reallocated engineering staff from consulting projects to strategically important research and development projects throughout 1998. The Company currently intends to grow consulting revenues in 1999 but this will be subject to the availability of engineering resource and the need to reallocate staff from consulting to research and development projects.

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 1998 was very similar to that of 1996, with revenues from the United States representing 53%, the Asia Pacific region 31%, and Europe 16%. 1997 had seen a bigger percentage of revenues from the United States, which in 1997 accounted for around two thirds of revenues.

Product Costs

Product costs are limited to variable costs of production such as the costs of manufacture of development systems and costs incurred in making third party operating systems compatible with the ARM® architecture. Product costs were £1.8 million in 1996, £3.5 million in 1997 and £3.9 million in 1998 representing 11%, 13% and 9% of total revenues in 1996, 1997 and 1998 respectively. The significant increase between 1996 and 1997 was due to costs incurred in porting a number of real time operating systems including Windows CE and Java software to run on the ARM® architecture. These costs levelled out in 1998 and the product gross margin increased to approximately 89% in 1998 compared to 82% in 1997. The Company does not currently expect a significant increase in product costs in 1999 although this may be subject to significant fluctuations as management decides to port different operating systems to run on the ARM® architecture.

Service Costs

Service costs include the costs of support and maintenance services to licensees of the technology as well as the costs directly attributable to consulting work performed for third parties. Cost of services increased from approximately £2.3 million in 1996 to £3.1 million in 1997 and £4.4 million in 1998. The service gross margin was approximately 40% in 1996, 51% in 1997 and 38% in 1998. During the year, the Company undertook one strategically important and complex consulting project which was less profitable than anticipated and this lowered the overall service gross margins.

Research and Development

Research and development costs increased from £2.9 million in 1996 to £6.1 million in 1997 and £11.6 million in 1998, representing 18%, 23% and 28% of total revenues, respectively. Included in research and development costs for 1997 and 1998 were non-cash compensation expense of £176,000 and £280,000 respectively relating to stock options granted between March 1997 and March 1998. The increase in research and development costs as a percentage of revenues demonstrates the Company's continual commitment to invest in developing next generation products. These include synthesisable versions of the ARM7® and ARM9® family products and the ARM10® which is being developed in the Company's Austin design centre. Total engineering headcount increased from 85 at the end of 1996, to 152 at the end of 1997 and 189 at the end of 1998. In addition to ARM staff, there were approximately 20 contractors employed at the end of 1996 and 1997 and approximately 30 contractors employed at the end of 1998 reflecting the difficulty in recruiting staff quickly enough to meet demand. Grant income receivable from the European Union, which is netted against research and development expenses, amounted to £0.5 million in 1996, £0.8 million in 1997 and £0.9 million in 1998. Absolute levels of grant income are not expected to differ materially in 1999.

Sales and Marketing

Sales and marketing expenditure increased from £3.3 million in 1996 to £5.4 million in 1997 and £7.6 million in 1998, representing 20% of total revenues in 1996, 20% in 1997 and 18% in 1998. Included in sales and marketing costs for 1997 and 1998 were non-cash compensation expense of £160,000 and £262,000 respectively relating to stock options granted between March 1997 and March 1998. Headcount in this area increased from 52 at the end of 1996 to 86 at the end of 1997 and 123 at the end of 1998. During 1998, the Company opened two sales and marketing offices in Paris, France and Westborough, near Boston, USA. This brings the total number of offices with sales people to 10 thus enabling improved contact with the Company's geographically diverse customer base. There are no immediate plans to open further offices although the Company may open one or two more sales offices over the next few years depending on market conditions.

General and Administrative

Administrative headcount increased from 25 at the end of 1996 to 36 at the end of 1997 and 42 at the end of 1998. General and administrative costs rose from £2.5 million in 1996 to £4.4 million in 1997 to £7.1 million in 1998, representing 15%, 17% and 17% of total revenues, respectively. Included in general and administrative costs in 1997 and 1998 were non-cash compensation expense of £128,000 and £180,000 respectively relating to stock options granted between March 1997 and March 1998. The increased level of cost in 1998 was due to a number of factors. These included the acquisition of additional office space in Tokyo, Japan, Austin Texas, USA and Maidenhead, UK and the compliance costs of being a dual listed company. In November 1998, the Company entered into agreements to lease a 45,000 square foot purpose built building on the Peterhouse Technology Park next to the existing offices in Cambridge and a 17,000 square foot new office in Los Gatos, California. These additions should enable the Company to accommodate over 650 staff worldwide and should be adequate for medium-term needs. Reflecting the general difficulties in the semiconductor and systems industry during 1998, the Company made a provision for doubtful debts of £0.2 million spread across 23 customers mainly relating to small consulting projects and some sales of development systems and training.

Interest and Similar Income

Interest and similar income grew from £0.1 million in 1996 to £0.6 million in 1997 and £1.9 million in 1998 reflecting the additional interest earned from the £34 million cash raised at the Company's initial public offering in April 1998. The Company invested these cash balances over periods of up to three months during the year as investment over longer periods did not generate a significantly higher return. Losses on foreign exchange amounted to £0.2 million in 1996, compared with an exchange gain of £0.1 million in 1997 and an exchange loss of less than £0.1 million in 1998. See "Foreign Currency Fluctuations" below.

Income before Income Tax

Income before income tax grew from £3.7 million in 1996 to £4.5 million in 1997 and £9.4 million in 1998 representing 22%, 17% and 22% of total revenues respectively. 1998 saw the first increase in the Company's pre-tax profit margins in three years. This growth in overall margins was principally attributable to the lower costs incurred in the porting of a number of real time operating systems to run on the ARM® architecture.

Tax Charge

The Company's effective tax rates were 28% in 1996, 36% in 1997 and 36% in 1998. The tax charge in 1996 was particularly low due to a large amount of "tax sparing" arising from sales to Korea. The inclusion of non deductible non cash compensation charge of £0.5 million in 1997 and £0.7 million in 1998 raised effective tax rates in both these years and will continue to affect the Company's tax rate adversely in 1999.

Liquidity and Capital Resources

The Company's operating activities provided net cash of £8.4 million, £1.5 million and £9.6 million in 1996, 1997 and 1998, respectively. In 1996, cash generated by operations was positively affected by the reduction in accounts receivable of £2.5 million and the increase in deferred revenues of £1.1 million and accrued liabilities and other creditors of £1.4 million. In 1997, cash generated by operations was adversely affected by the increase in accounts receivable of £4.7 million and the increase in prepaid expenses and other current assets of £1.5 million. In 1998, the net change in assets and liabilities was insignificant.

At December 31, 1998, the Company recorded approximately £4.4 million in deferred revenues (December 31, 1997 £3.7 million; December 31, 1996 £3.5 million) which represented cash or receivables scheduled to be recognized in revenues in varying amounts over the twelve months following December 31, 1998.

Cash flow from operations has been used to fund the working capital requirements of the Company as well as fixed asset expenditure. Capital expenditure in 1998 rose to £6.4 million compared to £4.0m in 1997 and £1.8 million in 1996. The increased expenditure in 1998 was largely due to the need to invest in new design automation tools and the costs of establishing new design centres in Austin, Texas and Maidenhead. The Company expects capital expenditure to continue to grow in 1999 with the addition of the new offices in Cambridge, UK and Los Gatos, California.

During 1996, the Company made two investments in small start-up companies, namely Sirius Communications NV and Palmchip Corporation ("Palmchip"). This amounted to £0.2 million in aggregate. In 1997, the Company made a further investment in Palmchip and converted its existing loan to give the Company a 45% shareholding. In 1998, the Company made no further investment in Palmchip. For the year ended December 31, 1998, the share of loss from Palmchip of £71,000 (1997: £31,000) was recognized in the income statement. During the year, the Company purchased an additional 10% stake in ARM Korea Limited. from Conhan Co. Limited, which had experienced financial difficulties during the year, for £23,000. This increased the Company's equity stake in ARM Korea Limited to 85%. The Company envisages making strategic investments in the future, in situations where the Company can broaden its product portfolio and where the potential for furthering ARM® based design wins is improved significantly.

In 1998, the Company received £34.0 million cash from its initial public offering in April 1998. The Company paid a dividend of £4 million in April 1998 to members on the share register as at March 31, 1998. The Company has also established an employee benefit trust, which purchased 250,000 shares at the Company's initial public offering for £1.4 million, funded by a loan from the Company.

Cash balances at December 31 were £10.1 million in 1996, £7.4 million in 1997 and £39.6 million in 1998. With a relatively small number of sales invoices, many of which have a high value, accounts receivable fluctuate considerably. At December 31, 1996, accounts receivable were £1.6 million compared to £6.3 million at December 31, 1997 and £8.9 million at December 31, 1998 which represented 10%, 24% and 21% of revenues, respectively.

Foreign Currency Fluctuations

The Company's earnings and liquidity are affected by fluctuations in foreign currency exchange rates, principally the U.S. dollar rate, reflecting the fact that most of the Company's revenues and cash receipts are denominated in U.S. dollars while the large majority of its costs are in sterling. The Company reduces this dollar/sterling risk where possible by currency hedging. Due to the high value and timing of receipts on individual licenses and the requirement to settle certain expenses in U.S. 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 dollars, which are negotiated with a major U.K. clearing bank. The average size of each forward contract was $2 million in 1996 and 1997 and $1.5 million in 1998. The Company does not currently use any other financial instruments or derivatives, although the Company is reviewing the use of instruments (such as currency options) for the same purposes as discussed above. The fair values of the financial instruments outstanding at the end of December 31, 1996, 1997 and 1998 are disclosed in note 11 to the financial statements. The settlement period of the forward contracts outstanding at December 31, 1998 is between February 1, 1999 and May 28, 1999.

Risk Factors

The Company believes that its future operating results will continue to be subject to quarterly variations based upon a wide variety of factors. These include the timing of entering into agreements with new licensees, the mixture of license fees, royalties and fees from services, and the introduction of new technology by the Company, the timing of orders from and shipments to systems companies of ARM®-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.

These risk factors are more fully discussed in the Company's annual report on Form 20-F for 1998.

Year 2000: State of Readiness

The Year 2000 issue arises from computer programs that were written to use two digits rather than four digits to indicate a particular year. Depending on a computer program's date sensitivity, the program may fail to process dates correctly, and such failure may result in a system shutdown or errors in calculation before or after the year 2000.

The Company began its Year 2000 project in the first quarter of 1998 and expects it to be completed by September 1999. The project has seven discrete stages: project definition, audit, prioritization, evaluation, testing, fixing and replacing.

The strategy adopted by the Company has been to conduct thorough audits of its systems using information made available by the suppliers of its hardware and software systems so as to reduce the need for excessive testing of items which may not require modification. The Company, which uses computer systems extensively, has recently completed the auditing and evaluation of all of its hardware and software systems. It estimates that approximately 30% of all the systems it uses already conform to Year 2000 requirements, with the remaining 70% known to have readily available solutions. The Company does not believe it has identified any systems that are critical to its business which are non Year 2000 compliant and do not have readily available solutions.

The testing stage of the project began during January 1999 and is expected to finish by the end of April 1999. The testing methodology used has been established in accordance with the British Standards Institute DISC PD-2000 Definition of Year 2000 Conformity Requirements. The objective of this stage is to test the solutions for identified hardware and software systems to ensure that these systems will cope with the Year 2000 date change.

The project has been managed by one individual who has employed two contractors for the purpose as well as the assistance of regular members of the Company's systems administration department. The project has been regularly reviewed by Company management and all staff have been made aware of the Year 2000 issue via internal seminars, meetings and publications. The total costs incurred to date, which relate solely to the cost of company employees and contractors, are approximately £0.1 million. The Company cannot precisely estimate the costs to completion of the project until the testing stage of the project is completed. However, the Company currently believes that the costs will not be material.

The Company's core business is the supply of intellectual property and so, with the exception of certain development systems sold by the Company, the Company has no material relationships with suppliers which would prevent the continuation of business if those suppliers were non compliant.

With respect to component suppliers for development systems, it has already been ascertained that the principal component supplier believes it is Year 2000 compliant. Consideration is being given to the accumulation of stock of certain components prior to the millenium in order to ensure no interruption in the sale of development systems, which in 1998 made up 10% of the Company's revenues. The Company is in the process of drafting other contingency plans for the Year 2000, which will be reviewed once testing is complete. The Company is reliant on systems considered to be the standard systems for the electronics industry. If the Company's computer systems were to fail in the Year 2000, the Company's product development would be temporarily affected but it believes that the activities would only be disrupted for a short period of time until the problems were resolved.

At this stage, the Company believes that the main risks, if any, would arise as a result of the failure of certain utilities such as electricity or telecommunications but that the additional costs of installing backup systems is not warranted. The Company currently has three design centres, two in the UK and one in Austin Texas, USA. In the event of lengthy disruption of services in any of these design centres, the Company would be able to temporarily relocate staff to another centre if project deadlines were becoming critical.

The general expectation by those who have studied best practice in managing the Year 2000 problem is that even the best run projects will face some Year 2000 compliance failures. There can be no assurance that Year 2000 projects will be successful or that the date change from 1999 to 2000 will not adversely affect the Company's operations and financial results. The Company may be adversely affected by the inability of third parties to manage the Year 2000 problem.

Impact of the Euro

The Company does not see any immediate impact to its business practices as a result of the introduction of the Euro.

	1996	1997	1998	1998*
	(in thousands, except share data)			
Revenues:				
Product revenues	£12,896	£20,143	£35,161	$58,501
Service revenues	3,798	6,437	7,107	11,824
Total revenues	16,694	26,580	42,268	70,325
Cost of revenues:				
Product costs	1,809	3,542	3,943	6,560
Service costs	2,286	3,143	4,373	7,276
Total cost of revenues	4,095	6,685	8,316	13,836
Gross profit	12,599	19,895	33,952	56,489
Operating expenses:				
Research and development	2,935	6,134	11,615	19,325
Sales and marketing	3,339	5,385	7,611	12,663
General and administrative	2,526	4,408	6,854	11,404
Provision for doubtful accounts	–	–	235	391
Total operating expenses	8,800	15,927	26,315	43,783
Income from operations	3,799	3,968	7,637	12,706
Provision against investment	(199)	–	–	–
Interest and similar income, net	72	604	1,865	3,103
Share of loss of equity affiliate	–	(31)	(71)	(118)
Minority interest	–	(15)	(8)	(13)
Income before income tax	3,672	4,526	9,423	15,678
Provision for income taxes	1,029	1,615	3,371	5,609
Net income	2,643	2,911	6,052	10,069
Net income	2,643	2,911	6,052	10,069
Other comprehensive income:				
Foreign currency adjustments	(46)	(83)	23	38
Total comprehensive income	2,597	2,828	6,075	10,107
Basic earnings per common share	684.2p	81.5p	8.6p	14.3¢
Earnings per common share (assuming dilution)	6.7p	7.1p	7.8p**	13.0¢

*Purely for the convenience of the reader, US Dollar amounts have been translated from Sterling at the December 31, 1998 closing rate of £1.00 = $1.6638.

**See footnote 4 for details of the antidilutive effect of the preference shares.

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

	1997	1998	1998*
	(in thousands, except share data)		
Assets			
Current assets:			
Cash and cash equivalents	£7,405	£39,591	$65,872
Accounts receivable, net of allowances for doubtful debts of £235,000 (1997: nil)	6,307	8,905	14,816
Inventory	163	221	368
Prepaid expenses and other assets	2,971	3,083	5,129
Total current assets	16,846	51,800	86,185
Deferred income taxes	259	730	1,215
Property and equipment, net	4,639	7,903	13,149
Prepayments and accrued income	16	17	28
Investments	201	130	216
Total assets	21,961	60,580	100,793
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	1,091	913	1,519
Income taxes payable	1,130	1,259	2,094
Personnel taxes	219	290	483
Accrued liabilities	3,292	5,352	8,905
Deferred revenue	3,732	4,436	7,381
Total liabilities	9,464	12,250	20,382
Minority interest	43	50	83
	9,507	12,300	20,465
Shareholders' equity			
Ordinary shares (£0.01 par value; 79,000,000 (1997: 10,325,000) authorized; 47,213,629 (1997: 9,080,270) issued)	91	472	785
Convertible preference shares (nil (1997: 68,675,000) authorized, nil (1997: 29,675,000) issued)	297	–	–
Additional paid in-capital	4,095	39,200	65,221
Cumulative translation adjustment	(132)	(109)	(181)
Retained earnings	8,103	10,155	16,896
Treasury stock, at cost (250,000 ordinary shares)	–	(1,438)	(2,393)
Total shareholders' equity	12,454	48,280	80,328
Total liabilities and shareholders' equity	21,961	60,580	100,793

* Purely for the convenience of the reader, US Dollar amounts have been translated from Sterling at the December 31, 1998 closing rate of £1.00 = $1.6638.

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

	1996	1997	1998	1998*
		(in thousands)		
Cash flows from operating activities				
Net income	£2,643	£2,911	£6,052	$10,069
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of goodwill	965	1,769	3,088	5,137
Stock option compensation	–	464	723	1,203
Share of loss of equity affiliates	–	31	71	118
Deferred income taxes	18	(46)	(471)	(784)
Provision for doubtful accounts	–	–	235	392
Provision against investments	199	–	–	–
Other	5	27	14	23
Changes in assets and liabilities				
Accounts receivable	2,538	(4,711)	(2,834)	(4,714)
Inventory	(42)	(97)	(58)	(97)
Prepaid expenses and other current assets	(727)	(1,491)	(112)	(186)
Accounts payable	(2)	584	(178)	(296)
Income taxes payable	166	1,149	255	425
Deferred revenue	1,088	186	704	1,171
Accrued liabilities and other creditors	1,388	639	2,060	3,427
Personnel taxes	14	91	71	118
Income taxes receivable	181	–	–	–
Net cash provided by operating activities	8,434	1,506	9,620	16,006
Cash flows from investing activities				
Purchase of equipment	(1,759)	(4,033)	(6,402)	(10,651)
Sale of equipment	16	10	38	63
Purchase of investments	(199)	(237)	(23)	(38)
Net cash used in investing activities	(1,942)	(4,260)	(6,387)	(10,626)
Cash flows from financing activities				
Payments of capital lease obligations	(4)	–	–	–
Dividend payment	–	–	(4,000)	(6,655)
Cash received on issue of shares net of issue expenses	–	151	34,342	57,138
Purchase of treasury stock	–	–	(1,438)	(2,393)
Net cash used in financing activities	(4)	151	28,904	48,090
Effect of foreign exchange on cash and cash equivalents	–	(107)	49	82
Net increase / (decrease) in cash and cash equivalents	6,488	(2,710)	32,186	53,552
Cash and cash equivalents at beginning of period	3,627	10,115	7,405	12,320
Cash and cash equivalents at end of period	10,115	7,405	39,591	65,872
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	285	529	3,497	5,818
Cash received on interest	(269)	(487)	(1,838)	(3,058)

* Purely for the convenience of the reader, US Dollar amounts have been translated from Sterling at the December 31, 1998 closing rate of £1.00 = $1.6638

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

	Ordinary shares		Preference shares		Additional paid-capital	Cumulative translation adjustment	Treasury stock	Retained earnings (1)	Total
	Number		Number						
				(in thousands, except share data)					
Balances, January 1, 1996	386,270	£4	34,675,000	£347	£3,517	£(3)	£–	£2,549	£6,414
Net income								2,643	2,643
Currency translation adjustment						(46)			(46)
Balances, December 31, 1996	386,270	4	34,675,000	347	3,517	(49)	–	5,192	9,011
Share issue on exercise of options	3,694,000	37			114				151
Conversion of preferred shares	5,000,000	50	(5,000,000)	(50)					–
Net income								2,911	2,911
Stock option compensation					464				464
Currency translation adjustment						(83)			(83)
Balances, December 31, 1997	9,080,270	91	29,675,000	297	4,095	(132)	–	8,103	12,454
Issue of ordinary shares	6,867,409	69			39,419				39,488
Share issue on exercise of options	1,590,950	15			273				288
Conversion of preferred shares	29,675,000	297	(29,675,000)	(297)					–
Net income								6,052	6,052
Stock option compensation					722				722
Tax compensation on exercise of share options					126				126
Dividends								(4,000)	(4,000)
Share issue expenses					(5,435)				(5,435)
Currency translation adjustment						23			23
Investment in treasury stock							(1,438)		(1,438)
Balances, December 31, 1998	47,213,629	472	–	–	39,200	(109)	(1,438)	10,155	48,280

(1) The amount of shareholders' equity available for distribution to shareholders is the amount of profits determined under UK GAAP in the statutory accounts of the parent company. At December 31, 1998 such distributable profits amounted to £10,964,000.

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

1 The Company and a summary of its significant accounting policies

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

Incorporation and history
The Company was incorporated on October 16, 1990 with the name Styletheme Limited, as a joint venture between Apple Computer (UK) Limited, Acorn Computers Limited and VLSI Technology Inc. On November 22, 1990 it changed its name to Advanced RISC Machines Holdings Limited. The Company has one wholly owned subsidiary, ARM Limited, incorporated as Widelogic Limited on November 12, 1990, which changed its name to Advanced RISC Machines Limited on November 22, 1990 and on April 6, 1998 to ARM Limited. In 1994, ARM, INC. and ARM KK were established in Los Gatos, California and Tokyo, Japan, respectively as subsidiaries of ARM Limited and act as marketing offices to assist in sales of ARM licenses in their respective territories. Additionally, ARM, INC. opened a research and development facility in Austin, Texas in 1997. In 1995, the group opened a representative office in Munich, Germany, and other offices in 1997 and 1998. In 1996, ARM Limited made a 3% equity investment in Sirius Communications NV and in January 1997, completed a 45% equity investment in Palmchip Corporation, a Delaware company. In 1997, ARM Korea Limited was established in South Korea as an 80% subsidiary of ARM Limited which was subsequently reduced to a 75% holding on December 31, 1997. ARM Limited purchased 10% in September 1998, increasing its holding to 85%.

Nominees of the Company hold 100% of the ordinary share capital of ARM Employee Benefit Trust Ltd, a company formed on April 16, 1998 to act as trustee to the group's employment benefit trust.

ARM Limited was previously called Advanced RISC Machines Limited and changed its name on April 6, 1998. During the year ARM Limited purchased an off-the-shelf company which changed its name to Advanced RISC Machines Limited. This company remained dormant throughout the year.

On March 10, 1998, the Company re-registered as a public company with the name ARM Holdings plc. The initial public offering followed on April 17, 1998.

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").

Purely for the convenience of the reader, the December 31, 1998 consolidated financial statements have been translated from sterling at the closing rate on December 31, 1998 at £1.00 = $1.6638. Such translations should not be construed as representations that sterling could be so converted into US Dollars at that rate or at any other rate.

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

Equity affiliates
Companies in which the group owns between 20% and 50% of the voting stock are treated as equity affiliates. The consolidated statement of income includes the group's share of net income of equity affiliates. The consolidated balance sheet includes investments in equity affiliates at the group's share of the net assets of those undertakings plus unamortized goodwill. Goodwill is written off over its expected useful economic life.

Revenue recognition
Revenue consists of license fees received under the terms of license agreements with customers to enable them to use the group's intellectual property ("IP") which is customized to each customer's manufacturing process. The group licenses its IP to leading international electronics companies which in turn manufacture, market and sell microprocessors, ASICs and ASSPs based on the group's architecture to systems companies for incorporation into a wide variety of end products. The group's IP consists of software and related documentation which enables a customer to design and manufacture microprocessors and related technology and software. Each license is designed to meet the specific requirements of each customer and is generally not time limited in its application. In general the time between the signing of a license and final customer acceptance is between nine and 15 months with most time allocated to the period between delivery and acceptance of the technology. Delivery generally occurs within a short time period after signing. The customer obtains license rights to the IP at the time of signing. In addition, the customer obtains ownership of the licensed rights to the in-process customization as well as the completed customization. License fees are invoiced according to an agreed set of milestone payments. Typically the first milestone is on signing of the contract, the second is on delivery of the customized IP (being the IP and other technical information relating to the product licensed) and the third is related to acceptance of the technology by the licensee. No upgrades or modifications to the licensed IP are provided. Following customer acceptance, the group has no further obligations under the license agreement.

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

Revenues from license fees are recognized based on the percentage to completion method over the period from signing of the license to customer acceptance. 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 to the total estimated project requirement, which corresponds to the costs of earned revenues.

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

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

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

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

Royalty revenues are earned on sales by the group's customers of products containing ARM® technology. Revenues are recognized when ARM receives notification from the customer of product sales.

Revenues from service and maintenance comprise revenues arising from consulting and support and maintenance contracts. Revenue from consulting is recognized when the service has been provided and all obligations to the customer under the consulting agreement have been fulfilled. Consulting costs are recognized when incurred. Revenue for support and maintenance is recognized on a straight-line basis over the period for which support and maintenance is contractually agreed by the group with the licensee.

Other revenues comprise the sale of boards and software toolkits. These revenues are recognized when the goods are delivered.

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

Grants
Grants in respect of specific research and development projects are receivable from the European Commission, a European organisation which funds certain research and development activities on application to it for the purposes of furthering research and development activities within the European Union. The group retains significant rights to intellectual property developed under projects which are funded under these arrangements. Grants received are intended to cover 50% of expected project costs. Grant income is recognized over the period of the project in line with the costs incurred. Unconditional undertakings have been received from the European Commission to provide the funding, and there is no obligation to refund any amounts already received. Amounts receivable under these arrangements in the year ended December 31, 1998 were £857,000 (1997: £750,000; 1996: £474,000) and were netted against related research and development costs.

Pension costs
The group contributes to defined contribution plans covering substantially all employees in the United Kingdom and the United States and to a government pension scheme for employees in Japan and South Korea. The group contributes to these plans based upon various fixed percentages of employee compensation and such contributions are expensed as incurred. The amount of contributions expensed by the group for the years ended December 31, 1996, 1997 and 1998 were £233,000, £392,000 and £628,000 respectively.

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

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

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

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:

Leasehold improvements	5 years or term of lease whichever is shorter
Computers and software	3 years
Fixtures and fittings	5 - 10 years
Motor vehicles	4 years

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

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

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

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

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

The group utilizes forward exchange contracts to hedge firm commitments related to accounts receivable denominated in a currency other than the functional currency of the business. The group's forward exchange contracts do not subject the group to risk from exchange rate movements because the gains and losses on such contracts offset losses and gains, respectively, on the transactions being hedged. Unrealized gains and losses on the forward exchange contracts are deferred and included in the measurement of the related foreign currency transaction. All recognized gains and losses resulting from the settlement of the contracts are recorded within interest and similar income in the income statement. The group does not enter into foreign exchange contracts for the purpose of hedging anticipated transactions.

Other transactions denominated in foreign currencies have been translated into sterling at actual rates of exchange ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies other than those specifically hedged have been translated at rates ruling at the balance sheet date. Exchange differences have been included in interest and similar income.

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.

Basic earnings per share
Basic earnings per common share is computed based on the weighted average number of ordinary shares. Earnings per common share (assuming dilution) is computed by including potential common shares and the conversion of convertible preference shares where the effect of their inclusion would be dilutive. The ordinary equivalent shares for share options were determined using the treasury stock method.

Accounting for stock based compensation
The group has elected to use the intrinsic value-based method to account for all of its employee stock based compensation plans. Under APB Opinion No. 25, Accounting for Stock Issued to Employees, the group has recorded no compensation costs related to its stock options granted in the years ended December 31, 1995 and 1996 because the exercise price of each option equals or exceeds the fair value of the underlying stock as of the grant date for each stock option. Compensation cost has been recognized for stock options granted in the year ended December 31, 1997 and in March 1998 because the exercise price of the options is less than the fair value of the underlying stock as of the grant date for each stock option. The group has adopted the disclosure requirements of the Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock Based Compensation.

Employee share ownership plan
Treasury stock represents the cost of shares in the Company held by the Employee Benefit Trust set up to facilitate the recruitment, retention and motivation of employees. The trust was set up on April 16, 1998. No options had been granted over these shares and no shares had been allocated at December 31, 1998. The market value of unearned shares at December 31, 1998 was approximately £3,194,000. All costs relating to the schemes are dealt with in the income statement as they accrue and the trust has waived the right to receive dividends of over and above 0.01p per share on all shares held.

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

Recently issued accounting standards
In 1998, the US Financial Accounting Standards Board issued SFAS Number 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS Number 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. The group is currently reviewing the likely impact in adopting this statement of its measurement of derivative instruments and on the disclosures currently provided in its financial statements.

Companies Act 1985
These financial statements do not comprise statutory accounts within the meaning of Section 240 of the Companies Act 1985 of Great Britain (the "Companies Act"). The Company's statutory accounts, which are its primary financial statements, are prepared in accordance with accounting principles generally accepted in the United Kingdom ("UK GAAP") in compliance with the Companies Act and are presented in pounds sterling. Statutory accounts (upon which the auditors gave unqualified reports under Section 235 of the Companies Act which did not contain statements under sub-sections 237(2) and (3) of the Companies Act) for the years ended December 31, 1996 and 1997 have been, and those for the year ended December 31, 1998 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

The directors regard Acorn Group plc, Apple Computer (UK) Limited and Palmchip Corporation as related parties.

Details of transactions between these parties and the Company's wholly owned subsidiary, ARM Limited, are as follows:

Apple Computer (UK) Limited
ARM Limited has a contract with Apple Computer Inc., the parent company of Apple Computer (UK) Limited, for the supply to Apple Computer Inc. of software and related support and maintenance to the value of £15,000 in the year ended December 31, 1998 (1997: £15,000; 1996: £62,000). Software services purchased from Apple Computer Inc. in 1998 were £5,000 (1997: £Nil; 1996: £53,000).

At December 31, 1998 an amount of £6,000 (1997: £6,000) remained outstanding and was included in accounts receivable.

Acorn Group plc
ARM Limited has engaged with Acorn Computers Limited, a subsidiary of Acorn Group plc, for the supply of design consulting services to the value of £24,000 in the year ended December 31, 1998 (1997: £322,000; 1996: £364,000) and has purchased items of hardware and services from Acorn Computers Limited to the value of £86,000 (1997: £205,000; 1996: £173,000).

In addition, during the year ended December 31, 1998 Acorn Computers Limited made an amount of consortium relief relating primarily to the 1997 UK tax year available to both the Company and ARM Limited of £506,000 (1997: £163,000 (relating to the 1996 UK tax year); 1996: £357,000 (relating to the 1995 UK tax year)).

At December 31, 1998 an amount of £155,000 (1997: £167,000) remained outstanding and was included in accrued liabilities.

Palmchip Corporation
ARM Limited supplied goods and services to Palmchip Corporation to the value of £1,000 (1997: £8,000) and has purchased consulting services from Palmchip Corporation to the value of £232,000 (1997: £79,000) in the year ended December 31, 1998. At December 31, 1998 an amount of £47,000 (1997: £8,000) remained outstanding and was included in accounts payable.

3 Income taxes

Income before income tax is analyzed as follows:

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
United Kingdom	£3,435	£3,661	£8,373
Foreign	237	865	1,050
	3,672	4,526	9,423

The provision for income taxes consisted of:

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
Current			
United Kingdom	£950	£1,191	£3,363
Foreign	62	470	479
Total current	1,012	1,661	3,842
Deferred			
United Kingdom	17	(22)	(336)
Foreign	–	(24)	(135)
Total deferred	17	(46)	(471)
Total provision for income taxes	1,029	1,615	3,371

Included in the provision for income taxes is an amount of £126,000 (1997 and 1996: £nil) in relation to employee stock options.

3 Income taxes (continued)

Total income tax expense differs from the amounts computed by applying the UK statutory income tax rate of 31% for 1998, 32% for 1997 and 33% for 1996 to income before income tax as a result of the following:

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
UK statutory rate 31% (1997: 32%, 1996: 33%)	£1,212	£1,448	£2,921
Permanent differences (1)	(154)	86	300
Differences in statutory rates of foreign countries	(17)	76	154
Other, net	(12)	5	(4)
	1,029	1,615	3,371

(1) Permanent differences comprise permanent disallowables, non-deductible stock option compensation and tax sparing.

Significant components of the deferred tax assets are as follows:

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
Fixed asset temporary differences	£211	£259	£307
Non-deductible accruals and reserves	2	–	423
	213	259	730

No valuation allowances have been recognized in any period.

UK income taxes have not been provided at December 31, 1998 on unremitted earnings of approximately £1,600,000 of subsidiaries located outside the United Kingdom as such earnings are considered to be permanently invested. If these earnings were to be remitted without offsetting tax credits in the United Kingdom withholding taxes would be approximately £80,000.

4 Earnings per share

Under the strict rules of SFAS 128, “Earnings per share”, the Company’s convertible preference shares must be omitted from the calculation of diluted earnings per share for 1998 as the related dividend, which was a one-off dividend payable on the Company’s initial public offering, has an antidilutive effect on diluted earnings per share. The preference dividend also reduces the income available to common shareholders for the calculation of basic earnings per share. The number of preference shares deemed to have an antidilutive effect are 8,699,247, representing potential common shares prior to conversion. The diluted earnings per share calculated including these shares as potential common shares and based on net income before the preference dividend is 12.5 pence per share.

	For the year ended December 31, 1996		
	Income	Shares	Per share amount
Net income	£2,643,000		
Basic EPS			
Income available to common stockholders	2,643,000	386,270	684.2p
Effect of dilutive securities			
Convertible preference shares		34,675,000	
Stock options		4,315,185	
Diluted EPS			
Income available to common stockholders plus assumed conversions	2,643,000	39,376,455	6.7p

4 Earnings per share (continued)

For the year ended December 31, 1997	Income	Shares	Per share amount
Net income	£2,911,000		
Basic EPS			
Income available to common stockholders	2,911,000	3,570,368	81.5p
Effect of dilutive securities			
Convertible preference shares		32,175,000	
Stock options		5,190,749	
Diluted EPS			
Income available to common stockholders plus assumed conversions	2,911,000	40,936,117	7.1p

For the year ended December 31, 1998	Income	Shares	Per share amount
Net income	£6,052,000		
Convertible preference dividend	(2,959,014)		
Basic EPS			
Income available to common stockholders	3,092,986	36,076,287	8.6p
Effect of dilutive securities			
Stock options		3,671,833	
Diluted EPS excluding preference dividend and preference shares prior to conversion	3,092,986	39,748,120	7.8p

5 Business risks and credit concentration

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

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

The group markets and sells to a relatively small number of customers with significantly large value transactions. For further information see footnote 10. At December 31, 1998 four customers accounted for 31.8%, 16.4%, 12.0% and 10% of accounts receivable respectively. At December 31, 1997, four customers accounted for 12.3%, 11.8%, 11.1% and 10.6% of accounts receivable respectively.

As of December 31, 1997 and 1998 the group's cash and cash equivalents were deposited with a major clearing bank in the UK in the form of money market deposits for varying periods of up to three months.

6 Investments

During the year ended December 31, 1996, ARM Limited loaned £179,000 to Palmchip Corporation, a company incorporated in the United States whose principal business activity is the development and supply of systems-on-chip solutions and associated engineering design services. A 100% provision has been made against this loan.

During the year ended December 31, 1997, ARM Limited acquired 45.4% of the share capital of Palmchip Corporation for consideration of £237,000 in cash and conversion of the loan of £179,000. The value of the investment at December 31, 1998 is represented by the group's share of the net assets of Palmchip Corporation of £88,000 (1997: £154,000) and goodwill of £42,000 (1997: £47,000).

7 Property and equipment

	31 December, 1997	1998
	(in thousands)	
Leasehold improvements	£439	£1,011
Computers and software	6,658	12,013
Fixtures, fittings and motor vehicles	1,248	1,636
	8,345	14,660
Less: accumulated depreciation	(3,706)	(6,757)
Property and equipment, net	4,639	7,903

Depreciation charged to income for the years ended December 31, 1996, 1997 and 1998 was £965,000, £1,764,000 and £3,083,000 respectively.

8 Shareholders' equity

Share capital
As part of the Company's initial public offering on April 17, 1998, 29,675,000 preference shares of 1p each were converted into 29,675,000 1p ordinary shares. The authorized preference shares were cancelled. 6,867,409 ordinary shares were issued on the same date for consideration of £39,487,601.

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 5 year period. Options issued prior to the listing of the Company are excluded from this calculation.

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

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

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

Option activity is summarized as follows:

	Outstanding options No. of shares	Weighted average exercise price
Balances, December 31, 1996	6,756,700	£0.13
Granted in year	1,859,015	£0.60
Lapsed in year	(80,000)	£0.52
Exercised in year	(3,694,000)	£0.04
Balances, December 31, 1997	4,841,715	£0.38
Granted in year	617,474	£4.66
Lapsed in year	(55,350)	£1.28
Exercised in year	(1,591,950)	£0.18
Balances, December 31, 1998	3,811,889	£1.14

8 Shareholders' equity – (continued)

The following options over ordinary shares were in existence at December 31, 1998:

Number of ordinary shares	Exercise price per share	Remaining contractual life	Exercise period	Exercisable at December 31, 1998
171,000	£0.09	4.1 years	1996 – 2003	171,000
212,500	£0.19	5.1 years	1997 – 2004	212,500
326,000	£0.35	6.1 years	1998 – 2005	326,000
652,750	£0.40	–	1999 – 2006	–
103,000	£0.40	–	1999 – 2003	–
812,515	£0.52	–	2000 – 2007	–
94,750	£0.52	3.2 years	1998 – 2002	94,750
582,500	£0.52	–	2000 – 2004	–
14,250	£0.52	3.3 years	1998 – 2002	14,250
32,500	£0.52	–	2000 – 2004	–
3,000	£0.85	3.4 years	1998 – 2002	3,000
35,000	£0.85	–	2000 – 2004	–
6,000	£1.25	3.5 years	1998 – 2002	6,000
19,000	£1.25	–	2000 – 2004	–
17,750	£1.25	3.8 years	1998 – 2002	17,750
80,000	£1.25	–	2000 – 2004	–
3,000	£1.25	4.0 years	1998 – 2002	3,000
35,000	£1.25	–	2000 – 2004	–
87,000	£2.25	–	2001 – 2008	–
108,000	£2.25	–	1999 – 2003	–
16,400	£7.75	–	1999 – 2003	–
23,200	£7.75	–	2001 – 2005	–
23,300	£10.55	–	2001 – 2008	–
14,250	£10.55	–	1999 – 2003	–
13,550	£8.10	–	2001 – 2008	–
4,750	£8.10	–	1999 – 2003	–
320,924*	£4.89	–	2000 – 2005	–
3,811,889				848,250

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

At December 31, 1998, the Company had three share option plans and two savings related share option schemes. The Company applies APB Opinion Number 25 and related interpretations in accounting for its plans. Non-cash compensation relating to stock options granted in the year ended December 31, 1997 and in March of 1998 at an exercise price below the fair value of the underlying stock on the grant date was recognized in an amount of £722,000 in the year ended December 31, 1998 (1997: £464,000). Such cost has been allocated according to the functional areas of the relevant employees as research and development expense in an amount of £280,000 (1997: £176,000), sales and marketing expense in an amount of £262,000 (1997: £160,000) and general and administrative expense in an amount of £180,000 (1997: £128,000). No compensation cost was recorded in the year ended December 31, 1996. Total remaining unrecognized compensation cost relating to 1997 and 1998 options is expected to be recognized as such options vest, in an amount of approximately £722,000 in the year ending December 31, 1999. For the year ending December 31, 1999, the compensation cost is expected to fall evenly over each quarter of the year.

8 Shareholders' equity – (continued)

Had compensation cost for the Company's share option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS Number 123, the group's net income and earnings per share would have been changed to the pro forma amounts indicated below:

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
Net income			
As reported	£2,643	£2,911	£6,052
Pro forma	£2,584	£2,755	£6,132
Basic earnings per common share			
As reported	684.2p	81.5p	8.6p
Pro forma	669.0p	77.2p	8.8p

The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 1998, 1997 and 1996; risk free interest rate of 6.1% (1997: 6.9%; 1996: 6.0%); expected life of 4 years; 60% (1997 and 1996: 65%) volatility; and no dividends.

9 Commitments

The group leases its office facilities and certain equipment under non-cancellable operating lease agreements which expire at various dates through 2004.

Future minimum lease commitments at December 31, 1998 are as follows:

Years ending December 31,	Operating leases (in thousands)
1999	£868
2000	1,680
2001	1,623
2002	1,444
2003	1,423
Thereafter	9,100
Total minimum lease payments	16,138

Rental expense under operating leases totalled £216,000, £353,000 and £433,000 for the years ended December 31, 1996, 1997 and 1998, respectively.

10 Geographic and segment information

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

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

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
Revenues (by market destination)			
Europe	£3,219	£3,823	£6,713
United States	8,096	17,423	22,442
Japan	3,158	3,148	12,295
South Korea	2,221	2,186	818
Total revenues	16,694	26,580	42,268

The group's exports from the United Kingdom were £15,467,000, £24,813,000 and £39,274,000 for the years ended December 31, 1996, 1997 and 1998, respectively.

	Year ended December 31,		
	1996	1997	1998
		(in thousands)	
Revenues (by origin)			
United Kingdom	£16,209	£25,050	£40,014
United States	369	1,187	1,502
Asia Pacific	116	343	752
Total revenues	16,694	26,580	42,268
Long-lived assets			
United Kingdom	2,415	4,262	7,275
United States	100	521	625
Asia Pacific	15	57	133
Total long-lived assets	2,530	4,840	8,033

The group had one customer in 1996 which individually accounted for 10.2% of the group's total revenues in the year. In 1997 and 1998, no single customer accounted for more than 10% of total revenues.

11 Fair values of financial instruments

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

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

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

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

	Year ended December 31,					
	1996		1997		1998	
	Carrying amount	Fair Value	Carrying amount	Fair value	Carrying amount	Fair value
	(in thousands)					
Cash and cash equivalents	£10,115	£10,115	£7,405	£7,405	£39,591	£39,591
Accounts receivable	1,596	1,596	6,307	6,307	8,905	8,905
Foreign currency contracts	–	(48)	–	28	–	23

REPORT OF INDEPENDENT ACCOUNTANTS

To the board of directors and shareholders of ARM Holdings plc

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of cash flow present fairly, in all material respects, the financial position of ARM Holdings plc and its subsidiaries at December 31, 1998 and 1997 and the results of their operations and their cash flow for the years ended December 31, 1998, 1997 and 1996 in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with generally accepted auditing standards in the United Kingdom which are substantially similar to those followed in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion expressed above.

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants
Cambridge, England
March 5, 1999

FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH UK GAAP

Introduction

In order to comply with applicable UK and US securities regulations, ARM Holdings plc prepares financial statements under both UK and US generally accepted accounting principles ("GAAP") both of which are included in this report.

The financial statements prepared under US GAAP can be found on pages 10 to 29, whilst this section of the report deals with financial information prepared under UK GAAP. A reconciliation of the differences between the two sets of GAAP can be found in note 29 of the UK GAAP financial statements.

Turnover

For the second year in succession turnover grew by 59%. Sales from the Far East grew particularly strongly, and accounted for around a third of the total in 1998 compared to 20% in 1997 while the United States accounted for slightly over half of all sales compared to around two thirds in 1997. Europe's share of turnover remained at around 15%. Following some consolidation on the part of four of our licensees, the year ended with 30 semiconductor partners in total.

Overall, license fees as a proportion of sales rose from 60% in 1997 to 64% in 1998. The ARM7TDMI® which was introduced in 1995 made up around two thirds of license fees in the year, slightly higher than in 1997. There were six new licensees in the year and the Company sold a further four ARM9® licenses to existing licensees. Since the year end, one more licensee took the ARM7TDMI® and a further three licensees took ARM9® licenses, bringing the total number of ARM9® licensees to ten.

Royalties grew by 64% between 1997 and 1998 to £3.6 million. During 1998, the Company ceased to make accruals for royalties relating to the current period, so bringing it into line with industry practice.

Turnover from the sale of development systems doubled to £4.4 million, being 10% of turnover. The increased demand reflected the number of engineers at our partners now working on ARM®-based designs, coupled with the fact that a number of new development system products were introduced during the year.

Consulting fell from £3.7 million in 1997 to £3.0 million in 1998 as the Company reallocated engineering staff from consulting projects to strategically important research and development projects.

Operating Expenses

As might be expected in a rapidly growing company, overheads were much higher in 1998 when compared to 1997. In total, operating expenses grew by 54% compared to 1997. Much of the additional costs were due to higher headcount which grew from 274 at the end of 1997 to 354 at the end of 1998. Other external charges rose by 38% compared to 1997 due to increased use of contractors reflecting the difficulty in recruiting staff quickly enough to meet demand. Depreciation rose by 75% to £3.1 million with the investment in new design automation tools. The opening of new offices near Boston, USA and Paris, France and the expansion of existing facilities in Tokyo, Maidenhead and Austin as well as the additional costs of compliance of being a dual listed company all contributed to the increase in operating expenses.

Earnings and Profit Margins

Despite the growth in costs, operating margins grew by 3%, thus reversing a trend over the last three years of decreasing margins. Profit before tax doubled to £10.1 million for the year, or 24% of sales. The Company's effective tax rate was just under 35%.

Cash Flow

The Company generated cash of £11.3 million from operating activities in 1998 and £6.4 million of this was spent on fixed assets. In April, a £4 million dividend was paid to shareholders on the members' register on March 31, 1998, and following the successful flotation of the Company in April, £34.3 million was raised, of which £1.4 million was invested in the Employee Benefit Trust in the form of Company shares. The Company's cash and short term investments balance at the end of the year thus rose to £39.6 million. The much higher cash balances resulted in a very substantial increase in interest received from £0.5 million in 1997 to £1.9 million in 1998.

Year 2000

For a disclosure on the progress of the Company's year 2000 project, please refer to page 14 of the Management's Discussion and Analysis in the US GAAP section of this report.

Impact of the Euro

The Company does not see any immediate impact to its business practices as a result of the introduction of the Euro.

Jonathan Brooks
Chief Financial Officer

Selected Financial Data - UK GAAP

	1998	1997	1996	1995
	£000	£000	£000	£000
Turnover	42,268	26,580	16,694	9,674
Net operating expenses	(33,954)	(22,028)	(13,291)	(7,300)
Share of loss of associated undertaking	(71)	(31)	–	–
Total operating profit	8,243	4,521	3,403	2,374
Interest receivable, net	1,911	484	269	247
Profit on ordinary activities before taxation	10,154	5,005	3,672	2,621
Tax on profit on ordinary activities	(3,507)	(1,661)	(1,012)	(676)
Profit on ordinary activities after taxation	6,647	3,344	2,660	1,945
Equity minority interest	(8)	(15)	–	–
Profit attributable to shareholders	6,639	3,329	2,660	1,945
Dividends	(4,000)	–	–	–
Retained profit for the financial year	2,639	3,329	2,660	1,945
Capital expenditure	6,402	4,033	1,759	1,147
Cash and cash equivalents	39,591	7,405	10,115	3,627
Shareholders' funds	49,324	12,195	8,798	6,184
Employees at end of year	354	274	162	129

Compliance with the Combined Code

The Company was listed on the London Stock Exchange in April 1998, and during the past year has been putting in place the necessary changes to its policy on corporate governance for it to substantially comply with the Combined Code as issued by the Hampel Committee on Corporate Governance. The areas of non compliance are as follows: firstly, until the appointment of Doug Dunn in December 1998, the lack of a third independent non executive director meant that the Company did not comply with provision A.3.2 of the Combined Code which requires that a majority of the non executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Secondly, the absence of a third independent non executive director meant that the composition of the audit committee for the period up to the appointment of Doug Dunn did not comply with provision D.3.1 of the Combined Code which requires that a majority of the non executive directors who comprise the audit committee should be independent. Thirdly, the Company did not establish a nominations committee in compliance with provision A.5.1 until December 1998. Finally, the composition of the remuneration committee which existed prior to the Company's flotation did not comply with provision B.2.2 of the Combined Code which requires that such committees should consist exclusively of independent non executive directors. Following the Company's listing, a new remuneration committee has been established and this first met in December 1998. It is currently in the process of re-evaluating the remuneration policy for executive directors as set by the previous remuneration committee.

In accordance with the provisions of the Combined Code, the Company is proposing a change to its articles of association such that all directors should be subject to re-election at intervals of no more than three years.

Composition and Operation of the Board
The board comprises the Chairman and Chief Executive Officer, two executive directors, three independent non executive directors, and one representative from the Company's largest shareholder, Acorn Group plc. The board has been established in order to give a balance of knowledge, experience and objective overview. The three executive directors provide the necessary skills in commercial, operational and financial management. The three independent non executive directors provide a blend of experience to enable them to bring strong independent judgement and considerable knowledge and experience to the board's deliberations. Peter Cawdron has significant experience of financial and strategic management both in the UK and United States and has extensive knowledge of UK public company issues. Larry Tesler, who during 1998 was the senior independent non executive director, has a broad understanding of technology and the practices of Silicon Valley based companies. Doug Dunn has experience of running significant companies in the semiconductor and electronics industry and provides a major contribution on operational and strategic issues.

In common with the Company's peers in the high technology sector in the United States, there is no separation of the functions of Chairman and Chief Executive. However, since the listing of the Company, the board has been strengthened considerably so as to ensure there is no undue dominance by the Chairman and Chief Executive. There are no plans to separate these roles in the near future, although this will be kept under review.

The board meets at least once a quarter and is responsible for the development of business and commercial strategy, monitoring progress, the approval of major business matters and policies and the approval of financial statements and of operating and capital expenditure budgets. The board is also responsible for sanctioning unusual commercial arrangements such as atypical license agreements. Prior to each meeting, the board is furnished with timely information in a form and quality appropriate for it to discharge its duties concerning the state of the business and performance compared to budget. Information is normally communicated electronically to board members. The non executive directors are also kept abreast of significant developments between board meetings by email. The ultimate responsibility for reviewing and approving the annual report and accounts and the quarterly reports, and for ensuring that they present a balanced assessment of the group's position, lies with the board. The board delegates the day-to-day responsibility of managing the group to a number of committees, details of which are set out below.

Executive Committee
The executive committee meets on a monthly basis and is responsible for the implementation of the strategy set by the board. It comprises the executive directors, the directors of ARM Limited and the presidents of ARM, INC. and ARM KK. Among other things, this committee is responsible for approval of standard license agreements, ensuring the group's budget and forecasts are properly prepared, ensuring targets are met, and generally managing the business within the overall budget. Deviations from the budget require approval from the main board of the Company.

Audit Committee
The audit committee has responsibility for, among other things, keeping under review the scope and results of the audit, the review of the annual report and accounts and half year interim report, the involvement of the auditors in that process, considering compliance with legal requirements, accounting standards, the rules of the London Stock Exchange and the SEC and for ensuring that an effective system of internal financial control is maintained. The audit committee comprises Peter Cawdron (Chairman), Doug Dunn and Larry Tesler. The committee keeps under review the independence and objectivity of the group's auditors, value for money of the audit and the nature, extent and cost-effectiveness of the non-audit services provided by the auditors. The committee meets three times a year, once to review the half year interim results, once before the year end to discuss the annual accounts and the approach to the audit, and once early in the year to review the previous year's results. The external auditors and Chief Financial Officer attend all meetings in order to ensure that all the information required by the audit committee is available for it to operate effectively. All directors may attend, and at least once a year, the representatives of the Company's auditors meet with the audit committee without any executive directors being present.

Remuneration Committee
The remuneration committee has responsibility for making recommendations to the board, within agreed terms of reference, on the Company's policy on executive remuneration and the individual remuneration packages for the executive directors including pension rights and any compensation payments. It is chaired by Doug Dunn. Peter Cawdron and Larry Tesler are also members of this committee which meets twice a year, once before the end of the year when remuneration issues are tabled for the subsequent year, and shortly afterwards in the new year to review the input of external advisers. The committee has access to professional advice from outside advisers in the furtherance of its duties and makes use of this. Coming from diverse backgrounds, the three independent non executive directors are able to offer a balanced view with respect to remuneration issues for the group. The Chief Executive Officer and Human Resources Manager will normally attend these meetings. The report of the board on remuneration is set out on page 36.

Nominations Committee

The nominations committee has responsibility for proposing to the board any new appointments of both executive and non executive directors. It is chaired by the Chairman and Chief Executive, and is attended by the three independent non executive directors, Doug Dunn, Peter Cawdron, and Larry Tesler.

Internal Financial Controls

The board of directors has overall responsibility for ensuring that the group maintains adequate systems of internal control. To this end, the board is reviewing its internal control systems in the light of the Combined Code and will report its review next year, after the guidance from the ICAEW committee has been issued. In the meantime, as allowed by the London Stock Exchange, the board reports its review of the effectiveness of internal financial control.

The key features of the financial controls of the group include a comprehensive system of financial reporting, budgeting and forecasting, and clearly laid down accounting policies and procedures. There are inherent limitations in all systems of internal financial control, and accordingly even the most effective system can provide only reasonable assurance with respect to the preparation of financial information and the safeguarding of assets

The group's organisational structure has clear lines of responsibility. Financial control for subsidiary companies is monitored centrally and authorisation of expenditures by overseas subsidiaries is closely monitored by the group's management. The group does not currently have an internal audit function but the need for this is reviewed from time to time.

A specific exercise has been undertaken to review and assess the risks facing the group's business and to identify weaknesses in systems of internal financial control. The results of this exercise have been reviewed by the board of directors.

Profit and loss, balance sheet and cash flow statements are prepared each month and are reviewed by the relevant executives. The board of the Company is furnished with financial information on a quarterly basis. The public release of quarterly financial information is not made until it has been reviewed by the board and by the group's auditors.

Relationships with Shareholders

Since the Company's listing on the London Stock Exchange and Nasdaq Stock Market in April 1998, the board has made considerable efforts to establish relationships with institutional shareholders. At present, nine analysts write research reports on the Company and it is likely that several more may be added in the near future. The board endeavours to make institutional presentations every six months in both Europe and the United States in order to communicate its objectives. The board is also keen to communicate with private investors and has set aside part of its web site for investor relations issues. It actively encourages participation at the Annual General Meeting on April 20, 1999.

Going Concern

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

Statement of Directors' Responsibilities

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

– select suitable accounting policies and then apply them consistently;

– make judgements and estimates that are reasonable and prudent;

– state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

– prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

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

By order of the board

David MacKay
Company Secretary

Remuneration Policy

The principal function of the remuneration committee is to make recommendations to the board on the remuneration and other benefits of all executive directors, including pension contributions, bonus payments, share options and service contracts. The remuneration committee in its current form first met in December of 1998 and in its deliberations on the Company's remuneration policy seeks to give full consideration to the Combined Code.

The Company established a remuneration policy before it was listed and so this policy pre-dates the establishment of the current remuneration committee.

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

Total Level of Remuneration

The remuneration committee aims to ensure that remuneration remains competitive with comparable public listed companies and that individuals are fairly rewarded for their contribution to the success of the company. There is a strong bonus element to executives' remuneration of between 20% and 45% of basic pay. In the last two years, bonuses of 30% and 35% respectively have been paid to executive directors. Bonuses are tied to the achievement of the group's annual budget, with 30% bonus being achieved if all targets are met. These include the level of sales and profit growth and forward orders generated for future periods. 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 and the Company believes this is still appropriate for the near future.

Service Agreements

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

Non Executive Directors

Each non executive director receives a total fee of £15,000 per annum. This fee has been arrived at by reference to fees paid by other companies of similar size and complexity, and reflects the amount of time non executive directors are expected to devote to the group's activities. The remuneration of the non executive directors is set by the board of the Company and their term of appointment is three years. Non executive directors do not have service contracts.

Remuneration and Directors' Interests

For details on individual director's emoluments and interests in share options see note 4 of the financial statements. For details of directors' shareholdings in the Company, please refer to the table in the directors' report.

Doug Dunn, OBE
Chairman of Remuneration Committee

The directors present their annual report and audited financial statements for the year to December 31, 1998.

Principal Activities and Review of Business

The principal activities of the Company and its subsidiaries are the licensing, marketing, research and development of RISC based microprocessors and systems. The nature of the global semiconductor industry is such that most of its business is conducted overseas and, to better serve its customers, the group has four offices in the United States, and offices in Tokyo, Japan; Seoul, South Korea; Paris, France and Munich, Germany. A review of business is set out in the Chairman and Chief Executive's Review on pages 2 to 5 and the Operating and Financial Review on page 32.

On March 6, 1998 the Company changed its name from Advanced RISC Machines Holdings Limited to ARM Holdings plc.

Future Developments

The Company's stated objective is to establish a new global RISC architecture standard for the embedded microprocessor market. The directors believe that to achieve this goal it is important to expand the number and range of potential customers for its technology. To this end, the Company intends to sign further license agreements with new customers and to establish relationships with more third party tools and software vendors to ensure that their products will operate on the ARM® architecture. The Company also plans to develop new technology to license to existing customers. To achieve its stated objective, the Company believes it will need to continue to increase its headcount over time in order to develop new technology and serve new customers. As a result of its position as an emerging standard in its industry, the group is presented from time to time with opportunities to acquire complementary technology or resources. However, at the present time, the group has no plans, commitments or understandings with respect to any such acquisitions.

Dividends

The Company paid an IPO dividend to ordinary and preference shareholders during 1998 of £4 million net of advanced corporation tax, being 9.97 pence per ordinary and preference share. This dividend, which was declared prior to the listing of the Company, was paid on April 27, 1998 to those ordinary and preference shareholders on the shareholders' register as at March 31, 1998.

With the exception of this dividend, the Company has never paid or declared any cash dividends on its shares. Although the policy will be kept under review, the directors do not anticipate paying dividends in the foreseeable future and do not recommend the payment of any final dividend for the year ended December 31, 1998.

Research and Development

Research and development activity is of major importance to the group. The key areas of new product development include the development of the ARM10™ Thumb® microprocessor, synthesisable versions of the ARM 9® family, and new versions of the group's software toolkit and development boards. The group does not undertake any pure research directly, but collaborates with universities. The profit and loss charge for the year for research and development was £13.8 million, or 33% of sales (1997: £6.7 million, or 25% of sales)

Donations

The group made charitable donations of £5,600 (1997: £5,200) during the year.

Land and Buildings

At December 31, 1998 the group did not own any land and buildings. However, on February 2, 1999 the group completed the purchase of the leasehold interest in a 13,000 square foot building from Element 14 Limited, a wholly owned subsidiary of Acorn Group plc, a transaction supported by independent valuation. This building was previously sub-leased from Element 14 Limited and was purchased as part of the group's plan to expand its principal site in Cambridge, UK.

An additional sum will be payable to Element 14 Limited if the group disposes of the property before June 23, 2013 for a net gain. A "net gain" will arise to the extent that the proceeds from the subsequent disposal of the property by the group exceed the aggregate of the original price of £190,000 (adjusted for indexation) and certain costs incurred by the group in relation to the property. The additional sum payable to Element 14 Limited will be 50% of any net gain. Acorn Group plc is a related party under the London Stock Exchange's Listing Rules by virtue of its interest in the equity capital of the Company.

Directors in the Year

The following served as directors of the Company during the year ended December 31, 1998.

- R Saxby (Chairman and Chief Executive Officer)
- J Brooks (Chief Financial Officer, appointed March 6, 1998)
- J Urquhart (Chief Operating Officer, appointed March 6, 1998)
- P Cawdron (independent non executive, appointed March 6, 1998)
- L Tesler (independent non executive, appointed March 6, 1998)
- D Dunn OBE (independent non executive, appointed December 7, 1998)
- S Boland (non executive, appointed July 2, 1998)
- P Bondar (non executive, resigned March 6, 1998)
- G Guyon de Chemilly (non executive, resigned March 6, 1998)
- D Lee (non executive, resigned July 2, 1998)
- G Wipfler (non executive, resigned January 15, 1999)

The board structure was altered in anticipation of the Company's initial public offering on March 6, 1998. On that date, Peter Bondar and Georges Guyon de Chemilly, both representatives of the principal shareholders, Apple Computer Inc and Acorn Group plc, respectively, resigned from the board. Peter Cawdron and Larry Tesler were appointed to the board as independent non executive directors and Jonathan Brooks and Jamie Urquhart were appointed to the board as executive directors.

David Lee resigned from the board on July 2, 1998 and was replaced by Stan Boland of Acorn Group plc.

Doug Dunn, OBE was appointed to the board on December 7, 1998, as the third independent non executive director.

Gary Wipfler of Apple Computer Inc resigned from the board on January 15, 1999. Apple Computer Inc has subsequently informed the Company that it no longer wishes to retain board representation.

During 1998, Larry Tesler was the senior independent non executive director, being the person whom any director could consult on any matters of concern.

The biographies of each of the directors are shown below.

Robin Saxby, 52, Chairman and Chief Executive Officer, joined the group from European Silicon Structures (ES2) where he was vice president of northern Europe, Managing Director of ES2 Limited and President of its American sister group US2. He was with ES2 for five years.

Prior to ES2 he was the CEO of Henderson Security Systems and before that spent 11 years with Motorola Semiconductors in various sales, marketing and engineering management positions. He holds a degree in electronics from Liverpool University. He is also a board member of Sirius Communications NV, in which ARM has a small shareholding. He is an advisor on the European R & D government industry and university collaboration, having chaired the OMI (Open Microprocessor Systems Initiative) advisory group.

Jonathan Brooks, 43, has been Chief Financial Officer since March 1995. Prior to this, he worked for the Accor Group SA where he was Finance Director of LV Group Limited between 1989 and 1991, Group Management Accountant based in Paris, between 1991 and 1993, and Finance Director of WL Japan KK between 1993 and 1995. Between 1988 and 1989 he was Group Financial Controller of Frederick's Place Holdings PLC. Previously, he had spent seven years with ICI PLC and two years with Grant Thornton management consultants. He holds a BSc (Economics) degree from the University of Wales, an MBA from the Manchester Business School, and is an associate of the Chartered Institute of Management Accountants.

Jamie Urquhart, 41, Chief Operating Officer, has been with ARM since its inception, and was one of the founding engineers of the ARM microprocessor. He served as Executive Vice President Sales and Marketing from 1996 to February 1998. He joined Acorn in 1984 to work on the ARM program and in 1985 became manager of the VLSI design group at Acorn. Prior to that he was with Plessey Research, where he worked on analog and digital developments utilising high speed CMOS, bipolar and gallium arsenide technologies. He holds a BSc in physics and physical electronics from Bath University.
Under the terms of their service contracts, Robin Saxby, Jonathan Brooks and Jamie Urquhart each have rolling notice periods of twelve months each.

Peter Cawdron, 55, worked for Grand Metropolitan PLC from 1983 to 1998, where he was Strategy Development Director from 1987 and Director of Planning before that. From 1977 to 1983, he was Chief Financial Officer of D'Arcy-MacManus & Masius Worldwide, Inc. Prior to that he spent seven years at S.G. Warburg & Co. Ltd and from 1961 to 1970 he worked at Peat, Marwick, Mitchell & Co. Mr Cawdron also serves as a non executive director of Compass Group plc, The Tetley Group plc, The Capita Group plc, Welcome Break Holdings Ltd, Johnston Press plc and Christian Salvesen plc. He was appointed to the board of the Company in March 1998.

Doug Dunn, OBE, 54, was appointed to the board of the Company in December 1998 as an independent non-executive director. From 1993 to 1998 he worked for Royal Philips Electronics N.V. initially as Chairman and CEO of the semiconductor division and member of the Philips group management committee. In 1996 he was appointed Chairman and CEO of the consumer electronics division and member of the Philips board. From 1980 to 1993 he was Managing Director of the Plessey and GEC Semiconductor divisions. Prior to this, he worked for Motorola. He has served on the boards of Interconnection Systems Ltd., TSMC, Allen Clarke Research Centre and JESSI and MEDEA, the two European initiatives in semiconductor and multimedia and he will be appointed to the board of management of ASML in April, 1999. He was awarded an OBE in 1992 for services to the electronics industry.

Larry Tesler, 53, is President of Stagecast Software Inc., a privately held company in California. From 1980 to 1997, he worked for Apple Computer, Inc., where he served as Vice President and Chief Scientist. Between 1963 and 1980, he was on the staff of the Xerox Palo Alto Research Center, the president of a software consulting firm, and a research associate at Stanford University, where he received a B.S. degree in 1965. Larry Tesler was a member of the board of the Company from its founding until August 1997 as a representative of Apple Computer Inc. and rejoined the board as an independent non executive director in March 1998.

Stan Boland, 39, is Chief Executive Officer of Acorn Group plc. Prior to joining Acorn in 1997, he worked for the ICL group of companies where he held senior financial positions including Director of Treasury and Tax and Financial Director of ICL Financial Services.

Election of directors

In accordance with the Company's articles, Robin Saxby and Jamie Urquhart retire by rotation at the Company's Annual General Meeting and will seek re-election at that meeting.

In accordance with provision A.6.2 of the Combined Code, which requires the election of directors by shareholders at the first opportunity after their appointment, Doug Dunn and Stan Boland who were appointed to the board during the year will submit themselves for election at the Company's Annual General Meeting.

Directors' Shareholdings in the Company

The interests of the directors in the ordinary 1p shares of the Company were as follows:

	December 31, 1998 Number	December 31, 1997 or on appointment Number
R Saxby[1,2]	1,370,950	1,632,000
J Brooks	–	–
J Urquhart[1,2]	220,200	295,200
P Cawdron	7,000	–
L Tesler	7,500	–
D Dunn[3]	–	–
S Boland	–	–

[1]Includes those held by immediate family.

[2]In February 1999, Robin Saxby sold 60,000 shares and Jamie Urquhart sold 50,000 shares.

[3]Doug Dunn purchased 2,400 shares in February 1999.

See Note 4 to the financial statements for details of directors' interests in share options.

In addition to the interests disclosed above, all the executive directors (together with all of the employees of the group) are potential beneficiaries of the ARM Holdings plc Employee Share Ownership Trust and are therefore treated as interested in all the shares held by the trustee, being 250,000 shares at the date of this report.

Substantial Shareholdings

At March 5, 1999 the Company had been notified of the following shareholdings amounting to 3% or more of the ordinary share capital of the Company:

	Ordinary shares of 1p each Number	Percentage
Acorn Group plc	11,561,961	24.5%
Apple Computer Inc	7,261,961	15.4%

The Company has not received notification that any other person holds more than 3% of the issued ordinary share capital.

Disabled Persons

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

Employee Involvement

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

Policy on Payment of Creditors

The group's policy is to pay suppliers within 21 days of the date of receipt of the invoice, unless terms have been specifically agreed in advance. This policy and any specific terms made with suppliers are made known to the appropriate staff and to suppliers on request. The average number of creditor days for the year ended December 31, 1998 was 13 days for the group (1997: 22 days), and nil days for the Company in both years. This figure was lower than normal in 1998 due to the method of calculation which includes all of the costs of the Company's initial public offering within the calculation.

Annual General Meeting

The Annual General Meeting will be held at the offices of Linklaters & Alliance at One Silk Street, London EC2Y 8HQ on April 20 1999 at 10.00 a.m. The notice of Annual General Meeting appears at the end of the Circular which accompanies this Annual Report.

Shareholders are invited to submit written questions in advance of the Meeting. Questions should be sent to the Secretary, ARM Holdings plc, 90 Fulbourn Road, Cambridge, CB1 4JN.

In addition to the ordinary business of an Annual General Meeting, it is proposed that the Company make certain minor amendments to its Articles of Association.

At the AGM in 1998, Coopers & Lybrand were appointed as the Company's auditors. On July 1, 1998 Coopers & Lybrand and Price Waterhouse merged to form a new firm PricewaterhouseCoopers. As a result of this merger, Coopers & Lybrand resigned as the Company's auditors and PricewaterhouseCoopers were appointed by the board on July 15, 1998 to fill the casual vacancy left by such resignation until the 1999 AGM. PricewaterhouseCoopers have indicated their willingness to accept reappointment as auditors of the Company. Accordingly, a resolution to appoint them, and to authorise the directors to determine their remuneration, will be proposed at the Meeting.

It is also proposed that the Company's share capital be re-organised by the subdivision of each issued and unissued Ordinary Share of 1p into four Ordinary Shares of 0.25p each. Details of that proposal are set out in the Circular which accompanies this Annual Report.

By order of the board

David MacKay
Company Secretary

March 5, 1999

	Notes	1998 £000	1997 £000
Turnover	2	42,268	26,580
Net operating expenses	3	(33,954)	(22,028)
Group operating profit		8,314	4,552
Share of loss of associated undertaking		(71)	(31)
Total operating profit		8,243	4,521
Interest receivable and similar income		1,933	502
Interest payable and similar charges	6	(22)	(18)
Profit on ordinary activities before taxation	2,7	10,154	5,005
Tax on profit on ordinary activities	8	(3,507)	(1,661)
Profit on ordinary activities after taxation		6,647	3,344
Equity minority interest	22	(8)	(15)
Profit attributable to shareholders		6,639	3,329
Dividends - including non-equity	10	(4,000)	–
Retained profit for the financial year	20	2,639	3,329
Earnings per 1p share	11		
Basic		10.3p	93.1p
Diluted		13.7p	8.1p

All activities relate to continuing operations.

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

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES UK FORMAT

ARM HOLDINGS PLC ANNUAL REPORT AND ACCOUNTS 1998

	Notes	1998 £000	1997 £000
Profit for the financial year		2,639	3,329
Foreign exchange difference on consolidation	20	23	(83)
Total recognised gains and losses for the year		2,662	3,246

	Notes	1998 £000	1997 £000
Fixed assets			
Tangible assets	12	7,903	4,639
Investments	13	1,568	201
		9,471	4,840
Current assets			
Stocks	14	221	163
Debtors: amounts falling due within one year	15	12,308	9,278
Debtors: amounts falling due after one year	15	33	16
Short term investments		37,095	5,333
Cash at bank and in hand		2,496	2,072
		52,153	16,862
Creditors: amounts falling due within one year	16	(12,250)	(9,464)
Net current assets		39,903	7,398
Total assets less current liabilities		49,374	12,238
Net assets		49,374	12,238
Capital and reserves			
Called up share capital	18	472	388
Share premium account	20	37,888	3,631
Other reserves	20	(109)	(132)
Profit and loss account	20	11,073	8,308
Shareholders' funds (below)	21	49,324	12,195
Minority interest - equity	22	50	43
		49,374	12,238
Shareholders' funds analysed as:			
Equity shareholders' funds		49,324	8,860
Non-equity shareholders' funds		–	3,335
		49,324	12,195

The financial statements on pages 40 to 61 were approved by the board of directors on March 5, 1999 and were signed on its behalf by:

Robin Saxby

Robin Saxby
Director

	Notes	1998 £000	1997 £000
Fixed assets			
Investments	13	1,438	–
Current assets			
Debtors: amounts falling due within one year	15	215	715
Debtors: amounts falling due after more than one year	15	6,521	2,750
Short term investments		32,150	1,180
Cash at bank and in hand		9	4
		38,895	4,649
Creditors: amounts falling due within one year	16	(486)	(149)
Net current assets		38,409	4,500
Net assets		39,847	4,500
Capital and reserves			
Called up share capital	18	472	388
Share premium account	20	37,888	3,631
Profit and loss account	20	1,487	481
Shareholders' funds		39,847	4,500
Analysed as:			
Equity shareholders' funds		39,847	1,165
Non-equity shareholders' funds		–	3,335
		39,847	4,500

The financial statements on pages 40 to 61 were approved by the board of directors on March 5, 1999 and were signed on its behalf by:

Robin Saxby
Director

	Notes	1998 £000	1997 £000
Net cash inflow from operating activities	23	11,304	1,548
Returns on investments and servicing of finance			
Interest received		1,840	487
Non-equity dividend paid		(2,959)	–
Net cash (outflow)/inflow from returns on investments and servicing of finance		(1,119)	487
Taxation			
Withholding tax paid		(754)	(185)
UK corporation tax paid		(1,925)	(155)
Overseas tax paid		(818)	(189)
Tax paid		(3,497)	(529)
Capital expenditure and financial investments			
Purchase of own shares	13	(1,438)	–
Purchase of tangible fixed assets		(6,402)	(4,033)
Sale of tangible fixed assets		38	10
		(7,802)	(4,023)
Acquisitions and disposals			
Purchase of further interest in subsidiary undertaking		(23)	(237)
Equity dividends paid		(1,041)	–
Net cash (outflow) before management of liquid resources		(2,178)	(2,754)
Management of liquid resources			
(Purchase)/sale of current asset investments		(31,762)	2,402
Financing			
Issue of shares		39,776	151
Expenses on issue of shares		(5,435)	–
		34,341	151
Increase/(decrease) in cash	24	401	(201)

1 Principal accounting policies

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently, is set out below.

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

Basis of consolidation
The consolidated profit and loss account and balance sheet include the financial statements of the Company and its subsidiary undertakings made up to 31 December 1998. Intra-group transactions and profits are eliminated fully on consolidation.

Associated undertakings
Companies in which the group has a participating interest are treated as associated undertakings. FRS9, "Associates and joint ventures" has been adopted and consequently the group's profit and loss account, balance sheet and cash flow statement have been presented in accordance with the requirements of the standard. The consolidated profit and loss account includes the group's share of profits less losses of associated undertakings. The consolidated balance sheet includes interests in associated undertakings at the value of the group's share of the net assets of those undertakings and the value of any goodwill not written off on acquisition or amortised.

Goodwill arising on the acquisition of Palmchip Corporation is being amortised over a period of 10 years, being the directors' best estimation of the useful economic life.

Short term investments
Bank deposits which are not re-payable on demand are treated as short term investments in accordance with Financial Reporting Standard No 1, revised in 1996. Movements in such investments are included under "management of liquid resources" in the group's cash flow statement.

Pension scheme arrangements
The group contributes to defined contribution plans, covering substantially all employees in the United Kingdom and the United States and to a government pension scheme for employees in Japan and South Korea. 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. The principal useful economic lives used for this purpose are:

Leasehold improvements	5 years or term of lease whichever is shorter
Computers and software	3 years
Fixtures and fittings	5 - 10 years
Motor vehicles	4 years

FRS11, "Impairment of fixed assets and goodwill", came into effect for these financial statements, but has not resulted in any changes in presentation.

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

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

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

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

Income from the sale of licences is recognised on a percentage to completion basis over the period from signing of the licence to customer acceptance. Under the percentage to completion method, provisions for estimated losses on uncompleted contracts are recognised in the period in which the likelihood of such losses is determined.

1 Principal accounting policies – (continued)

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

Income from consultancy is recognised when obligations are fulfilled; income from the sale of boards and software tools is recognised when goods are delivered; royalty income is recognised when ARM receives notification from the customer of product sales; and income for support and maintenance is recognised over the period in which the maintenance service is provided.

Deferred taxation

Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability or asset will crystallise.

Foreign currency

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

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

Research and development

All ongoing 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") is a separately administered trust, funded by a loan from the group, the assets of which comprise shares in the Company. The assets of the ESOP are included in the consolidated financial statements.

Grants

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

Changes in presentation of financial information

FRS 14, "Earnings per share", has been adopted and, consequently, basic and diluted earnings per share have been calculated in accordance with the new methodology. Comparative basic and diluted earnings per share for 1997 have been recalculated on the same basis.

2 Segmental analysis

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

Turnover by destination

	1998 £000	1997 £000
Europe	6,713	3,823
US	22,442	17,423
Asia Pacific	13,113	5,334
	42,268	26,580

Turnover by origin

	1998 Total sales £000	1998 Inter-segment sales £000	1998 External sales £000	1997 Total sales £000	1997 Inter-segment sales £000	1997 External sales £000
Europe	41,455	(1,441)	40,014	26,120	(1,070)	25,050
US	9,232	(7,730)	1,502	4,955	(3,768)	1,187
Asia Pacific	1,402	(650)	752	971	(628)	343
	52,089	(9,821)	42,268	32,046	(5,466)	26,580

Profit before taxation by origin

	1998 £000	1997 £000
Europe	9,095	4,031
US	903	750
Asia Pacific	156	224
	10,154	5,005

Net assets

	1998 £000	1997 £000
Europe	47,599	11,036
US	1,287	893
Asia Pacific	488	309
	49,374	12,238

3 Net operating expenses

	1998 £000	1997 £000
Other external charges	(7,522)	(5,470)
Changes in stock of finished goods	58	42
Staff costs (see note 5)	(14,053)	(8,684)
Depreciation	(3,083)	(1,764)
Other operating charges	(10,211)	(6,902)
Grant income receivable	857	750
	(33,954)	(22,028)

4 Directors' emoluments

The emoluments of the directors of the Company were paid through its wholly owned subsidiary, ARM Limited, and were as follows:

	Fees £	Basic salary £	Benefits £	Bonus payments £	Pension contributions £	Total 1998 £	Total 1997 £
Executive							
R Saxby	–	125,000	9,939	43,750	16,425	195,114	175,851
J Brooks	–	68,282	7,598	23,899	6,828	106,607	–
J Urquhart	–	67,292	7,868	23,552	6,729	105,441	–
	–	260,574	25,405	91,201	29,982	407,162	175,851
Non-executive							
P Cawdron[1]	11,250	–	–	–	–	11,250	–
L Tesler[1]	11,250	–	–	–	–	11,250	–
D Dunn OBE[2]	–	–	–	–	–	–	–
S Boland[3]	–	–	–	–	–	–	–
G Wipfler[3]	–	–	–	–	–	–	–
P Bondar[3]	–	–	–	–	–	–	–
D Lee[3]	–	–	–	–	–	–	–
G Guyon de Chemilly[3]	–	–	–	–	–	–	–
	22,500	–	–	–	–	22,500	175,851
	22,500	260,574	25,405	91,201	29,982	429,662	175,851

(1) Messrs Brooks, Urquhart, Cawdron and Tesler were appointed to the board on 6 March 1998. These amounts represent the remuneration paid to them from the date of appointment.

(2) Mr Dunn OBE was appointed on 7 December 1998 and received no fees in 1998.

(3) Messrs Boland, Wipfler, Bondar, Lee and Guyon de Chemilly did not receive directors' fees as they were representatives of their companies, Acorn Group plc and Apple Computer Inc, which had significant shareholdings in the Company during the year.

The three 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.

4 Directors' emoluments – (continued)

Options over shares in Company

Details of options held by directors are set out below:

Director	As at 1 January 1998* Number	Granted Number	Exercised Number	As at 31 December 1998 Number	Exercise price	Earliest date of exercise	Expiry date
R Saxby	70,000	–	–	70,000	£0.09	29/01/96	28/01/03 a
	70,000	–	–	70,000	£0.19	07/02/97	06/02/04 a
	35,000	–	–	35,000	£0.35	16/02/98	15/02/05 a
	30,000	–	–	30,000	£0.40	15/07/99	14/07/03 b
	205,000	–	–	205,000			
J Brooks	19,000	–	–	19,000	£0.40	15/07/99	14/07/06 a
	185,000	–	–	185,000	£0.52	05/03/00	04/03/04 b
	204,000	–	–	204,000			
J Urquhart	20,000	–	–	20,000	£0.35	16/02/98	15/02/05 a
	19,000	–	–	19,000	£0.40	15/07/99	14/07/03 b
	43,500	–	–	43,500	£0.52	05/03/00	04/03/04 b
	82,500	–	–	82,500			

* Or appointment if later

(a) Denotes share options issued under the Company's approved share option scheme

(b) Denotes share options issued under the Company's unapproved share option scheme

None of the share options issued have performance conditions attached to them.

The market value of the shares of the Company as at 31 December 1998 was £12.775. The closing mid price ranged from £7.50 to £13.125 during the period since flotation on 17 April 1998.

5 Employee information

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

By activity	1998 Number	1997 Number
Research and development	173	121
Administration	39	30
Sales and marketing	102	70
	314	221

Staff costs (for the above persons)	1998 £000	1997 £000
Wages and salaries	12,353	7,601
Social security costs	1,072	691
Other pension costs	628	392
	14,053	8,684

Of the total pension costs above, £Nil (1997: £Nil) remained unpaid at the year end.

6 Interest payable and similar charges

	1998 £000	1997 £000
Bank charges	22	18

7 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	1998 £000	1997 £000
Hire of plant and machinery – operating leases	26	50
Hire of other assets – operating leases	407	303
Depreciation charge for the year:		
Tangible owned fixed assets	3,083	1,764
Loss on disposal of tangible fixed assets	14	20
Loss on disposal of share in subsidiary	–	5
Amortisation of goodwill on associate	5	5
Auditors' remuneration:		
Audit services (Company £3,000 (1997: £2,000))	50	30
Non-audit services	214	90
Research and development	13,767	6,708

Auditors' remuneration for non–audit services of £232,000, relating to the Company's flotation, was charged to the share premium account and is not reflected in the above figures.

Non-audit fees of a total of £446,000 for PricewaterhouseCoopers in 1998 include £396,000 paid to Coopers & Lybrand prior to the date of appointment of PricewaterhouseCoopers as auditors. Non audit fees in 1997 comprise solely amounts paid to Coopers & Lybrand.

8 Tax on profit on ordinary activities

	1998 £000	1997 £000
United Kingdom corporation tax at 31% (1997: 31.5%):		
Current	3,446	1,349
Deferred	(336)	–
Overseas taxation	479	470
	3,589	1,819
Relief for overseas taxation:		
Tax spared	(44)	(189)
(Over)/under provision in respect of prior years:		
Current	(38)	31
	3,507	1,661

9 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 for the financial year before dividends payable was £5,006,000 (1997: £2,948).

10 Dividends

	1998 £000	1997 £000
Equity – ordinary		
IPO dividend paid 9.97p (1997: £Nil) per 1p share	1,041	–
Non – equity		
IPO dividend paid 9.97p (1997: £Nil) per 1p share	2,959	–
	4,000	–

11 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 employee share trust (note 13) 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: those share options granted to employees where the exercise price is less than the market price of the Company's ordinary shares at the date of exercise; and preference shares, which were converted into ordinary shares during the year. During the year ended 31 December 1998, the Company declared a special one-off dividend, at the time of its initial public offering, to all of its shareholders. The special preference dividend must be deducted from the profit attributable to shareholders in determining the earnings available to ordinary shareholders, which has the effect of reducing basic earnings per share. Generally, diluted earnings per share are lower than basic earnings per share. However, in this situation, the reverse is the case because the majority of the IPO dividend was paid to preference shareholders.

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

	1998 Earnings £000	1998 Number of shares (thousands)	1998 Per share amount	1997 Earnings £000	1997 Number of shares (thousands)	1997 Per share amount
Profit attributable to shareholders	6,639			3,329		
Less: preference dividend	(2,959)			–		
Basic EPS						
Earnings available to ordinary shareholders	3,680	35,900	10.3p	3,329	3,577	93.1p
Effect of dilutive securities:						
Options		3,686			2,846	
Convertible preference shares	2,959	8,699		–	34,675	
Diluted EPS						
Adjusted earnings	6,639	48,285	13.7p	3,329	41,098	8.1p

The calculation of basic earnings per share for the year ended 31 December 1997 excludes all convertible preference shares which were considered to be non equity shares. These shares are included in the calculation of basic earnings per share in the year ended 31 December 1998 from the date of conversion.

12 Tangible fixed assets

Group

	Leasehold improvements £000	Computers and software £000	Fixtures, fittings and motor vehicles £000	Total £000
Cost				
At 1 January 1998	439	6,658	1,248	8,345
Exchange differences	–	(4)	–	(4)
Additions	572	5,441	389	6,402
Disposals	–	(82)	(1)	(83)
At 31 December 1998	1,011	12,013	1,636	14,660
Depreciation				
At 1 January 1998	173	3,138	395	3,706
Exchange differences	–	–	(2)	(2)
Charge for year	149	2,672	262	3,083
Disposals	–	(29)	(1)	(30)
At 31 December 1998	322	5,781	654	6,757
Net book value				
At 31 December 1998	689	6,232	982	7,903
At 31 December 1997	266	3,520	853	4,639

The Company does not own any tangible fixed assets.

13 Fixed asset investments

Group

	Associated undertaking £000	Other investments £000	Investment in own shares £000	Total £000
Cost or valuation				
At 1 January 1998	385	20	–	405
Additions	–	–	1,438	1,438
Share of loss for the year	(66)	–	–	(66)
At 31 December 1998	319	20	1,438	1,777
Amounts written off				
At 1 January 1998	184	20	–	204
Amortisation of goodwill	5	–	–	5
At 31 December 1998	189	20	–	209
Net book value				
At 31 December 1998	130	–	1,438	1,568
At 31 December 1997	201	–	–	201

Associated undertaking

The investment in the associated undertaking comprises:

	£000
Share of associated undertaking's net assets	88
Goodwill	42
	130

13 Fixed asset investments – (continued)

ARM Limited holds 100% of the `A' preferred share capital of Palmchip Corporation, being a holding of 45.4% in the total share capital of the company. The company is incorporated in the USA and the principal business activity is the development and supply of systems-on-chip solutions and associated engineering design services.

Other investments

Other investments represent the group's 3% holding, held by ARM Limited, of the share capital of Sirius Communications NV whose principal business activity is the design and sale of spread spectrum transceivers which can be integrated into microcontrollers. Full provision has been made against this investment.

Investment in own shares

Investment in own shares held represents the cost of shares in the Company held by the group's Employment Benefit Trust and are disclosed as a fixed asset investment in accordance with Urgent Issues Task Force Abstract Number 13 ("Accounting for ESOP Trusts"). The trust was set up on 16 April 1998 and purchased shares at the time of the Company's flotation using funds provided by the Company.

No options had been granted over these shares at 31 December 1998.

As at 31 December 1998 the trust held 250,000 shares (nominal value £2,500) with a market value of £3,193,750.

All costs relating to the schemes 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 0.01p per share on all shares held.

Company	Investment in own shares £000	Interests in group undertakings £000	Total £000
Cost and net book value			
At 1 January 1998	–	–	–
Additions	1,438	–	1,438
At 31 December 1998	1,438	–	1,438

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%

The group holds two 100% investments in overseas subsidiaries, via its subsidiary company, ARM Limited. These are ARM, INC. (USA) and ARM KK (Japan). At the year end the group also held an 85% investment in ARM Korea Limited, a subsidiary of ARM Limited.

The countries of incorporation of the above subsidiaries are the USA, Japan and South Korea respectively.

The principal activities of ARM Limited and ARM, INC. are the marketing, research and development of RISC based microprocessors. The principal activity of the other overseas subsidiaries is the marketing of RISC based microprocessors.

During 1998 ARM Limited purchased an off-the-shelf company, registered in England and Wales, which changed its name to Advanced RISC Machines Limited. This company was dormant throughout the year.

In addition, nominees of the Company hold 100% of the ordinary share capital of ARM Employee Benefit Trustee Ltd, a company formed on 16 April 1998 to act as trustee to the group's employment benefit trust.

ARM Limited was previously called Advanced RISC Machines Limited and changed its name on 6 April 1998 to ARM Limited.

14 Stocks

Group	1998 £000	1997 £000
Finished goods	221	108
Work in progress	–	55
	221	163

The Company had no stocks at 31 December 1998 and 1997.

15 Debtors

	Group		Company	
	1998 £000	1997 £000	1998 £000	1997 £000
Amounts falling due within one year				
Trade debtors	8,905	6,307	–	–
Prepayments and accrued income	2,482	2,422	215	609
Other debtors	585	549	–	106
Deferred tax (see note 17)	336	–	–	–
	12,308	9,278	215	715
Amounts falling due after more than one year				
Amounts owed by group undertakings	–	–	6,521	2,750
Prepayments and accrued income	33	16	–	–
	33	16	6,521	2,750
	12,341	9,294	6,736	3,465

16 Creditors: amounts falling due within one year

	Group		Company	
	1998 £000	1997 £000	1998 £000	1997 £000
Trade creditors	913	1,091	–	–
Amounts owed to group undertakings	–	–	9	10
Corporation tax less ACT paid	1,259	1,130	477	24
Other taxation and social security	290	325	–	106
Other creditors	149	176	–	9
Accruals and deferred income	9,639	6,742	–	–
	12,250	9,464	486	149

The corporation tax creditor has been reduced by £766,000 (1997: £382,000) relating to overseas withholding tax.

17 Deferred taxation

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

	1998 £000	1997 £000
At 1 January	–	–
Credited to the profit and loss account	336	–
At 31 December	336	–

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

	Amount recognised		Amount not recognised	
	1998 £000	1997 £000	1998 £000	1997 £000
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	–	–	(307)	(235)
Other	(336)	–	(87)	(24)
	(336)	–	(394)	(259)

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.

18 Called up share capital

	1998 £000	1997 £000
Authorised		
79,000,000 ordinary shares of 1p each (1997: 10,325,000)	790	103
Nil preference shares (1997: 68,675,000 of 1p each)	–	687
	790	790
Allotted, called up and fully paid		
47,213,629 ordinary shares of 1p each (1997: 9,080,270)	472	91
Nil preference shares (1997: 29,675,000 of 1p each)	–	297
	472	388

As part of the Company's initial public offering on 17 April 1998, the 29,675,000 preference shares of 1p each were converted into 29,675,000 1p ordinary shares. The authorised preference shares were cancelled. 6,867,409 (nominal value £68,674) ordinary shares were issued on the same date for consideration of £39,487,601.

In addition, a further 1,590,950 ordinary shares of 1p each were issued in the year for cash consideration of £288,792. The issue of these shares occurred on the exercise of share options at various times during the year.

18 Called up share capital – (continued)

Share options

The Company had the following ordinary share options outstanding at 31 December 1998.

Date of issue	Ordinary shares of 1p each Number	Exercise price	Period of option Earliest date	Latest date
29 January 1993	171,000	£0.09	29 January 1996	28 January 2003
7 February 1994	212,500	£0.19	7 February 1997	6 February 2004
16 February 1995	326,000	£0.35	16 February 1998	15 February 2005
15 July 1996	652,750	£0.40	15 July 1999	14 July 2006
15 July 1996	103,000	£0.40	15 July 1999	14 July 2003
5 March 1997	812,515	£0.52	5 March 2000	4 March 2007
5 March 1997	94,750	£0.52	5 March 1998	4 March 2002[2]
5 March 1997	582,500	£0.52	5 March 2000	4 March 2004
30 April 1997	14,250	£0.52	30 April 1998	29 April 2002[2]
30 April 1997	32,500	£0.52	30 April 2000	29 April 2004
29 May 1997	3,000	£0.85	29 May 1998	28 May 2002[2]
29 May 1997	35,000	£0.85	29 May 2000	28 May 2004
25 June 1997	6,000	£1.25	25 June 1998	24 June 2002[2]
25 June 1997	19,000	£1.25	25 June 2000	24 June 2004
1 October 1997	17,750	£1.25	1 October 1998	30 September 2002[2]
1 October 1997	80,000	£1.25	1 October 2000	30 September 2004
24 December 1997	3,000	£1.25	24 December 1998	23 December 2002[2]
24 December 1997	35,000	£1.25	24 December 2000	23 December 2004
7 March 1998	87,000	£2.25	7 March 2001	6 March 2008
7 March 1998	108,000	£2.25	7 March 1999	6 March 2003[2]
17 April 1998[1]	320,924	£4.89	17 April 2000	16 October 2005
8 June 1998	16,400	£7.75	8 June 1999	7 June 2003[2]
8 June 1998	23,200	£7.75	8 June 2001	7 June 2005
17 August 1998	23,300	£10.55	17 August 2001	16 August 2008
17 August 1998	14,250	£10.55	17 August 1999	16 August 2003[2]
16 October 1998	13,550	£8.10	16 October 2001	15 October 2008
16 October 1998	4,750	£8.10	16 October 1999	15 October 2003[2]
Total	3,811,889			

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

(2) 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.

19 Acquisitions

The group purchased a further 10% of ARM Korea Limited, increasing its holding from 75% to 85% during the period, for consideration, paid in cash, of £23,000. No goodwill arose on the acquisition.

20 Share premium account and reserves

Group	Share premium account £000	Other reserves £000	Profit and loss account £000
At 1 January 1998	3,631	(132)	8,308
Foreign exchange difference on consolidation	–	23	–
Premium on issue of new shares	39,419	–	–
On exercise of share options	273	–	–
Issue expenses	(5,435)	–	–
Credit on US employee share options	–	–	126
Retained profit for the year	–	–	2,639
At 31 December 1998	37,888	(109)	11,073

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

Company	Share premium account £000	Profit and loss account £000
At 1 January 1998	3,631	481
Premium on issue of new shares	39,419	–
On exercise of share options	273	–
Issue expenses	(5,435)	–
Retained profit for the year	–	1,006
At 31 December 1998	37,888	1,487

21 Reconciliation of movements in shareholders' funds

	1998 £000	1997 £000
Profit for the financial year	2,639	3,329
Other recognised gains and losses relating to the year	23	(83)
New share capital issued	84	37
Share premium on issue of new shares	39,692	114
Issue expenses	(5,435)	–
Credit on US employee share options	126	–
Net addition to shareholders' funds	37,129	3,397
Opening shareholders' funds	12,195	8,798
Closing shareholders' funds	49,324	12,195

22 Minority interests

	1998 £000
At 1 January 1998	43
New minority interest arising	(1)
Profit and loss account	8
Equity minority interests at 31 December 1998	50

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

	1998 £000	1997 £000
Operating profit	8,314	4,552
Depreciation on tangible fixed assets	3,083	1,764
Loss on sale of tangible fixed assets	14	20
Loss on disposal of share in subsidiary	–	5
Amortisation of goodwill	5	5
(Increase) in stocks	(58)	(97)
(Increase) in trade debtors	(2,598)	(4,711)
(Increase) in prepayments and accrued income	(77)	(1,252)
(Decrease)/increase in trade creditors	(178)	584
(Decrease) in other taxation and social security	(71)	(41)
Increase in accruals, deferred income and other creditors	2,870	719
Net cash inflow from operating activities	11,304	1,548

24 Reconciliation of net cash flow to movement in net funds

	1998 £000	1997 £000
Increase/(decrease) in cash for the year	401	(201)
Cash outflow/(inflow) from purchase/(sale) of current asset investments	31,762	(2,402)
Change in net funds from cash flows	32,163	(2,603)
Other non-cash items:		
Translation difference	23	(107)
Movement in net funds in the year	32,186	(2,710)
Net funds at start of period	7,405	10,115
Net funds at end of period	39,591	7,405

25 Analysis of net funds

	Cash at bank and in hand £000	Current asset investments £000	Total £000
At 1 January 1998	2,072	5,333	7,405
Cash flow	401	31,762	32,163
Exchange movements	23	–	23
At 31 December 1998	2,496	37,095	39,591

26 Capital commitments

	Group 1998 £000	Group 1997 £000
Capital expenditure that has been contracted for but has not been provided for in the financial statements	451	–

27 Financial commitments

At 31 December 1998 the group had annual commitments under non–cancellable operating leases as follows:

	1998 Land and buildings £000	1998 Other £000	1997 Land and buildings £000	1997 Other £000
Expiring within one year	27	1	16	1
Expiring between two and five years inclusive	321	26	204	29
Expiring in over five years	1,354	–	189	–
	1,702	27	409	30

At 31 December 1998 the Company had no annual commitments under non–cancellable operating leases.

28 Related party transactions

The Company has taken advantage of the exemption available to parent companies under Financial Reporting Standard 8 ("Related Party Disclosures") where transactions and balances between group entities have been eliminated on consolidation.

The directors regard Acorn Group plc and Apple Computer (UK) Limited as related parties by virtue of their both having an interest in the equity capital of the Company during the year. The directors regard Palmchip Corporation as a related party by virtue of its being an associated party.

28 Related party transactions – (continued)

Details of transactions between these parties and the Company's wholly owned subsidiary, ARM Limited, are as follows:

Apple Computer (UK) Limited
ARM Limited supplied goods and services to Apple Computer Inc., the parent company of Apple Computer (UK) Limited, to the value of £15,126 (1997: £15,267) in the period and purchased software services to the value of £5,051 (1997: £Nil).

At the year end an amount of £5,592 (1997: £6,077) remained outstanding and was included in trade debtors.

Acorn Group plc
ARM Limited supplied goods and services to Acorn Computers Limited, a subsidiary of Acorn Group plc, to the value of £23,500 (1997: £322,138) in the year. The group also purchased items of hardware and services from Acorn Computers Limited to the value of £86,145 (1997: £205,456).
In addition, during the year Acorn Computers Limited has made amounts of tax consortium relief relating primarily to the 1997 accounting period available to both the Company and its subsidiary, ARM Limited, as follows:

ARM Holdings plc £8,191 (1997: £9,023 relating to the 1996 accounting period).

ARM Limited £497,604 (1997: £154,367 relating to the 1996 accounting period).

At the year end an amount of £155,376 (1997: £166,822) remained outstanding and was included in trade creditors.

Palmchip Corporation
ARM Limited supplied goods and services to Palmchip Corporation to the value of £1,068 (1997: £8,316) and has purchased consulting services to the value of £231,725 (1997: £78,626) in the year.

At the year end an amount of £46,692 (1997: £8,453) remained outstanding and was included in trade creditors.

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

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

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

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

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

Consolidated profit and loss account
Under UK GAAP, the consolidated profit and loss accounts of the group are presented in accordance with format 2 set out in Schedule 4 to the Companies Act 1985. The format and classification of income and expenses differs under US GAAP.

Under UK GAAP, operating profit is stated after foreign exchange gains and losses. Under US GAAP, income from operations is stated before foreign exchange gains and losses.

Under UK GAAP, profit before tax is stated before minority interests. Under US GAAP, income before income tax is stated after minority interests.

Dividends
Under UK GAAP, retained profit is stated after dividends paid and proposed. Under US GAAP, net income is stated before dividends.

Earnings per share
Diluted earnings per share for the year ended 31 December 1998 under UK GAAP (see note 11) has been calculated based on profit before preference dividend and assuming conversion of preference shares at the beginning of the year. The calculation for the same period under US GAAP has used profit after preference dividend with no assumed conversion of preference shares.

Investment in own shares/treasury stock
Under UK GAAP, the shares held by the group in the Employee Share Ownership Trust are included as "Investment in own shares" within fixed asset investments. Under US GAAP, these shares are treated as treasury stock and are included within shareholders' equity.

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

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

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

	1998 £000	1997 £000
Group operating profit as reported under UK GAAP	8,314	4,552
Adjustments for:		
Share option compensation cost	(723)	(464)
Foreign exchange losses/(gains)	46	(120)
Income from operations as reported under US GAAP	7,637	3,968

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

	1998 £000	1997 £000
Profit before tax as reported under UK GAAP	10,154	5,005
Adjustments for:		
Share option compensation cost	(723)	(464)
Minority interest	(8)	(15)
Income before income tax as reported under US GAAP	9,423	4,526

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

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

	1998 £000	1997 £000
Retained profit as reported under UK GAAP	2,639	3,329
Adjustments for:		
Movements in deferred tax assets on temporary timing differences	136	46
Dividend	4,000	–
Share option compensation cost	(723)	(464)
Net income as reported under US GAAP	6,052	2,911

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

	1998 £000	1997 £000
Shareholders' funds as reported under UK GAAP	49,324	12,195
Adjustment for:		
Recognition of deferred tax assets on temporary timing differences	394	259
Investment in own shares/treasury stock	(1,438)	–
Shareholders' equity as reported under US GAAP	48,280	12,454

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

	1998 £000	1997 £000
Cash as reported under UK GAAP	2,496	2,072
Adjustment for short term investments treated as cash equivalents under US GAAP	37,095	5,333
Cash and cash equivalents as reported under US GAAP	39,591	7,405

Report of the auditors' to the members of ARM Holdings plc

We have audited the financial statements on pages 40 to 61, which have been prepared under the accounting policies set out on pages 44 to 45.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report including, as described on page 35, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

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

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 33 to 35 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or the group's corporate governance procedures or its internal controls.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the the state of affairs of the Company and the group at 31 December 1998 and the profit and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Cambridge
March 5, 1999

ARM Holdings plc
90 Fulbourn Road
Cambridge
CB1 9JN

Tel: +44 1223 400400
Fax: +44 1223 400410

ARM Ltd
48-49 Bateman Street
Cambridge
CB2 1LR

Tel: +44 1223 400500
Fax: +44 1223 400408

ARM Ltd
Liberty House
Moorbridge Road
Maidenhead
Berkshire
SL6 8LT

Tel: +44 1628 427700
Fax: +44 1628 427701

ARM France
12 Avenue des Pres
BL204 Montigny le
Bretonneux
78059 St. Quentin en Yvelines,
France

Tel: +33 1 30790510
Fax: +33 1 30790511

ARM Germany
Otto-Hahn Strasse 13b
Ottobrunn bei München
85521
Germany

Tel: +49 89 608 75545
Fax: +49 89 608 75599

ARM, INC.
10900 NE 8th Street
Suite 920
Bellevue
WA98004
USA

Tel: +1 425 450 4840
Fax: +1 425 454 4383

ARM, INC.
112 Turnpike Road
Suite 111
Westborough
MA01581
USA

Tel: +1 508 616 0775
Fax: +1 508 616 0774

ARM, INC.
Suite 150
750 University Avenue
Los Gatos
CA 95054
USA

Tel: +1 408 399 5199
Fax: +1 408 399 8854

ARM, INC.
1250 Capital of Texas Highway
Bldg 3, Suite 560
Austin
TX78746
USA

Tel: +1 512 327 9249
Fax: +1 512 314 1078

ARM KK
Plustaria Bldg 4F
3-1-4 Shinyokohama
Kohoku-ku
Yokohama-Shi
222-0033
Japan

Tel: +81 45 477 5260
Fax: +81 45 477 5261

ARM Korea Limited
Room 1809
Windstone Hoficetel
275-2 Yangjae-Dong
Seocho-Ku, Seoul
Korea

Tel: +82 2 3462 8271
Fax: +82 2 3462 8274

FOR MORE INFORMATION
PLEASE VISIT OUR WEB SITE AT

http://WWW.ARM.COM

Secretary and Registered Office
David N MacKay
90 Fulbourn Road
Cambridge
CB4 1JN
United Kingdom

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

Legal Advisers

As to English Law
Linklaters & Alliance
One Silk Street
London
EC2Y 8HQ
United Kingdom

As to U.S. Law
Davis Polk & Wardwell
1 Frederick's Place
London
EC2R 8AB
United Kingdom

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

Registrars
Lloyds Bank Plc
Lloyds Bank Registrars
The Causeway
Worthing
West Sussex
BN99 6DA
United Kingdom

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

Robin Saxby
Chairman and Chief
Executive Officer

Jonathan Brooks
Chief Financial Officer

Jamie Urquhart
Chief Operating Officer

Peter Cawdron
Independent
Non Executive

Doug Dunn
Independent
Non Executive

Larry Tesler
Independent
Non Executive

Stan Boland
Non Executive

ARM Holdings plc
90 Fulbourn Road,
Cambridge CB1 4JN