ARRIS GROUP INC
Form 10-Q
May 06, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
For the quarter ended March 31, 2011
of
ARRIS GROUP, INC.

A Delaware Corporation
IRS Employer Identification No. 58-2588724
SEC File Number 000-31254
3871 Lakefield Drive
Suwanee, GA 30024
(678) 473-2000

ARRIS Group, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.
ARRIS Group, Inc. is a large accelerated filer and is not a shell company.
ARRIS is required to submit electronically and post on its corporate web site Interactive Data Files required to be submitted and posted pursuant to Rule 405 of regulation S-T.
As of April 30, 2011, 123,768,762 shares of the registrant s Common Stock, $0.01 par value, were outstanding.

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FORM 10-Q
For the Three Months Ended March 31, 2011
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PART I. CONDENSED FINANCIAL INFORMATION
Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

ARRIS GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data) (unaudited)

	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 358,747	$ 353,121
Short-term investments, at fair value	260,862	266,981
Total cash, cash equivalents and short-term investments	619,609	620,102
Restricted cash	4,176	4,937
Accounts receivable (net of allowances for doubtful accounts of $1,765 in 2011 and $1,649 in 2010)	149,976	125,933
Other receivables	5,275	6,528
Inventories (net of reserves of $15,866 in 2011 and $16,316 in 2010)	105,787	101,763
Prepaids	12,115	9,237
Current deferred income tax assets	20,450	19,819
Other current assets	33,535	33,054
Total current assets	950,923	921,373
Property, plant and equipment (net of accumulated depreciation of $114,703 in 2011 and $109,267 in 2010)	56,617	56,306
Goodwill	233,471	234,964
Intangible assets (net of accumulated amortization of $235,623 in 2011 and $226,679 in 2010)	159,672	168,616
Investments	32,787	31,015
Noncurrent deferred income tax assets	10,183	6,293
Other assets	5,798	5,520
	$ 1,449,451	$ 1,424,087
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 35,796	$ 50,736
Accrued compensation, benefits and related taxes	26,278	28,778
Accrued warranty	2,931	2,945
Deferred revenue	43,019	31,625
Other accrued liabilities	17,594	18,847
Total current liabilities	125,618	132,931
Long-term debt, net of current portion	205,447	202,615
Accrued pension	17,472	17,213
Noncurrent income tax liability	21,844	17,702
Noncurrent deferred income tax liabilities	25,827	29,151

Other noncurrent liabilities	18,271	15,406
Total liabilities	414,479	415,018
Stockholders equity:		
Preferred stock, par value $1.00 per share, 5.0 million shares authorized; none issued and outstanding		
Common stock, par value $0.01 per share, 320.0 million shares authorized; 123.7 million and 120.8 million shares issued and outstanding in 2011 and 2010, respectively	1,438	1,409
Capital in excess of par value	1,219,615	1,206,157
Treasury stock at cost, 19.8 million shares in 2011 and 2010	(145,286)	(145,286)
Accumulated deficit	(36,042)	(47,606)
Unrealized gain on marketable securities (net of accumulated tax effect of $224 in 2011 and 2010)	1,244	392
Unfunded pension liability (net of accumulated tax effect of $662 in 2011 and 2010)	(5,813)	(5,813)
Cumulative translation adjustments	(184)	(184)
Total stockholders equity	1,034,972	1,009,069
	$ 1,449,451	$ 1,424,087

See accompanying notes to the condensed consolidated financial statements.

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ARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data and percentages) (unaudited)

	Three Months Ended March 31,	
	2011	2010
Net sales:		
Products	$ 234,946	$ 240,141
Services	32,490	26,556
Total net sales	267,436	266,697
Cost of sales:		
Products	152,755	139,820
Services	17,735	14,366
Total cost of sales	170,490	154,186
Gross margin	96,946	112,511
Operating expenses:		
Selling, general, and administrative expenses	36,838	35,118
Research and development expenses	36,040	34,365
Restructuring charges		52
Amortization of intangible assets	8,944	9,021
Total operating expenses	81,822	78,556
Operating income	15,124	33,955
Other expense (income):		
Interest expense	4,225	4,430
Gain on investments	(423)	(146)
Loss (gain) on foreign currency	888	(268)
Interest income	(778)	(374)
Other expense (income), net	(113)	(42)
Income from continuing operations before income taxes	11,325	30,355
Income tax expense (benefit)	(239)	11,364
Net income	$ 11,564	$ 18,991
Net income per common share:		
Basic	$ 0.09	$ 0.15
Diluted	$ 0.09	$ 0.15

Weighted average common shares:		
Basic	122,297	125,967
Diluted	125,732	129,975

See accompanying notes to the condensed consolidated financial statements.

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ARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands) (unaudited)

	Three Months Ended March 31,	
	2011	**2010**
Operating activities:		
Net income	$ 11,564	$ 18,991
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	5,855	5,359
Amortization of intangible assets	8,944	9,021
Stock compensation expense	5,284	4,521
Deferred income tax provision (benefit)	(7,844)	(4,495)
Amortization of deferred finance fees	163	180
Provision for doubtful accounts		295
Gain on investments	(423)	(146)
Loss on disposal of fixed assets	34	11
Excess income tax benefits from stock-based compensation plans	(3,700)	(2,486)
Non-cash interest expense	2,832	2,883
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	(24,043)	4,206
Other receivables	534	2,420
Inventories	(4,024)	15,944
Income taxes payable and recoverable	2,270	9,167
Accounts payable and accrued liabilities	(7,048)	(24,935)
Prepaids and other, net	6,031	7,274
Net cash provided by (used in) operating activities	(3,571)	48,210
Investing activities:		
Purchases of property, plant and equipment	(6,251)	(4,654)
Cash proceeds from sale of property, plant and equipment	42	240
Purchases of investments	(99,361)	(42,436)
Sales of investments	105,949	2,100
Net cash provided by (used in) investing activities	379	(44,750)
Financing activities:		
Payment of debt obligations		(37)
Repurchase of common stock		(3,059)
Excess income tax benefits from stock-based compensation plans	3,700	2,486
Repurchase of shares to satisfy employee tax withholdings	(8,245)	(5,993)
Proceeds from issuance of common stock	13,363	2,622
Net cash provided by (used in) financing activities	8,818	(3,981)

Net increase (decrease) in cash and cash equivalents	5,626	(521)
Cash and cash equivalents at beginning of period	353,121	500,565
Cash and cash equivalents at end of period	$ 358,747	$ 500,044

See accompanying notes to the condensed consolidated financial statements.

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ARRIS GROUP, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Organization and Basis of Presentation

ARRIS Group, Inc. (together with its consolidated subsidiaries, except as the context otherwise indicates, ARRIS or the Company), is a global communications technology company, headquartered in Suwanee, Georgia. ARRIS operates in three business segments, Broadband Communications Systems, Access, Transport & Supplies, and Media & Communications Systems, specializing in integrated broadband network solutions that include products, systems and software for content and operations management (including video on demand, or VOD), and professional services. ARRIS is a leading developer, manufacturer and supplier of telephony, data, video, construction, rebuild and maintenance equipment for the broadband communications industry. In addition, ARRIS is a leading supplier of infrastructure products used by cable system operators to build-out and maintain hybrid fiber-coaxial (HFC) networks. The Company provides its customers with products and services that enable reliable, high speed, two-way broadband transmission of video, telephony, and data.

The condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for a fair presentation of the consolidated financial statements for the periods shown. Interim results of operations are not necessarily indicative of results to be expected from a twelve-month period. These financial statements should be read in conjunction with the Company s most recently audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the United States Securities and Exchange Commission (SEC).

Note 2. Impact of Recently Adopted Accounting Standards

In January 2010, the FASB issued new guidance on the disclosures of fair value measurements. The new guidance amends the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires disclosure of transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy, including the reasons and the timing of the transfers and information on purchases, sales, issuance, and settlements on a gross basis in the reconciliation of the assets and liabilities measured under Level 3 of the fair value measurement hierarchy. The guidance was effective for annual and interim reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual and interim periods beginning after December 15, 2010. The Company adopted the amendments for Levels 1 and 2 on January 1, 2010 and the adoption did not have a material impact on the disclosures in the Company s consolidated financial statements. The Company adopted the amendment for Level 3 on January 1, 2011, and the adoption did not have a material impact on the disclosures in the Company s consolidated financial statements.

Note 3. Investments

ARRIS investments as of March 31, 2011 and December 31, 2010 consisted of the following (in thousands):

	As of March 31, 2011	As of December 31, 2010
Current Assets:		
Available-for-sale securities	$ 260,862	$ 266,981
Noncurrent Assets:		
Available-for-sale securities	28,787	27,015
Cost method investments	4,000	4,000
	32,787	31,015
Total	$ 293,649	$ 297,996

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ARRIS investments in debt and marketable equity securities are categorized as available-for-sale. The Company currently does not hold any held-to-maturity securities. Realized gains and losses on trading securities and available-for-sale securities are included in net income. Unrealized gains and losses on available-for-sale securities are included in our consolidated balance sheet as a component of accumulated other comprehensive income (loss). Realized and unrealized gains and losses in total and by individual investment as of March 31, 2011 and December 31, 2010 were not material. The amortized cost basis of the Company s investments approximates fair value.

As of March 31, 2011 and December 31, 2010, ARRIS cost method investment is an investment in a private company, which is recorded at cost of $4.0 million. Each quarter ARRIS evaluates its investment for any other-than-temporary impairment, by reviewing the current revenues, bookings and long-term plan of the private company. In the third quarter of 2010, the private company raised additional financing at the same price and terms that ARRIS had invested. As of March 31, 2011, ARRIS believes there has been no other-than-temporary impairment but will continue to evaluate the investment for impairment. Due to the fact the investment is in a private company, ARRIS is exempt from estimating the fair value. However, ARRIS is required to estimate the fair value if there has been an identifiable event or change in circumstance that may have a significant adverse effect on the fair value of the investment.

Classification of available-for-sale securities as current or non-current is dependent upon management s intended holding period, the security s maturity date and liquidity consideration based on market conditions. If management intends to hold the securities for longer than one year as of the balance sheet date, they are classified as non-current.

Note 4. Fair Value Measurement

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the FASB has established a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The following table presents the Company s investment assets and foreign currency contract positions measured at fair value on a recurring basis as of March 31, 2011 (in thousands):

	Level 1	**Level 2**	**Level 3**	**Total**
Current investments	$75,366	$185,496	$	$260,862
Noncurrent investments	6,784	22,003		28,787
Foreign currency contracts asset position				
Foreign currency contracts liability position	1,802			1,802

All of the Company s short-term investments and long-term investments instruments are classified within Level 1 or Level 2 of the fair value hierarchy as they are valued using quoted market prices, market prices for similar securities, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include the Company s investment in money market funds, mutual funds, U.S. government bonds and investments in public companies. Such instruments are generally classified within Level 1 of the fair value hierarchy. The types of instruments valued based on other observable inputs include the Company s cash surrender value of company owned life insurance, corporate obligations and bonds, commercial paper and certificates of deposit. Such instruments are classified within Level 2 of the fair value hierarchy. See Note 3 and Note 5 for further information on the Company s investments and derivative instruments.

All of the Company s foreign currency contracts are over-the-counter instruments. There is an active market for these instruments, and therefore, they are classified as Level 1 in the fair value hierarchy. ARRIS does not enter into currency contracts for trading purposes. The Company has a master netting agreement with the primary counterparty to the derivative instruments. This agreement allows for the net settlement of assets and liabilities arising from different transactions with the same counterparty.

Note 5. Derivative Instruments and Hedging Activities

ARRIS has certain international customers who are billed in their local currency. Changes in the monetary exchange rates may adversely affect the Company s results of operations and financial condition. When appropriate, ARRIS enters into various derivative transactions to enhance its ability to manage the volatility relating to these typical business exposures. The Company does not hold or issue derivative instruments for trading or other speculative purposes. The Company s derivative instruments are recorded in the Consolidated Balance Sheets at their fair values. The Company s derivative instruments are not designated as hedges, and accordingly, all changes in the fair value of the instruments are recognized as a loss (gain) on foreign currency in the Consolidated Statements of Operations. The maximum time frame for ARRIS derivatives is currently less than twelve months. Derivative instruments which are subject to master netting arrangements are not offset in the Consolidated Balance Sheets.

The fair values of ARRIS derivative instruments recorded in the Consolidated Balance Sheet as of March 31, 2011 and December 31, 2010 were as follows (in thousands):

	As of March 31, 2011		**As of December 31, 2010**	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Not Designated as Hedging Instruments:				
Foreign exchange contracts asset derivatives	Other current assets	$	Other current assets	$607
Foreign exchange contracts liability derivatives	Other accrued liabilities	$1,802	Other accrued liabilities	$828

The change in the fair values of ARRIS derivative instruments recorded in the Consolidated Statements of Operations during the three months ended March 31, 2011 and 2010 were as follows (in thousands):

	Statement of Operations Location	**Three Months Ended March 31,**	
		2011	**2010**
Derivatives Not Designated as Hedging Instruments:			
Foreign exchange contracts	Loss (gain) on foreign currency	$ 2,133	$ (609)

Note 6. Pension Benefits

Components of Net Periodic Pension Cost (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Service cost	$ 78	$ 68
Interest cost	536	529
Expected return on plan assets	(406)	(380)
Amortization of prior service cost		65

Amortization of net loss		72		70
Net periodic pension cost	$	280	$	352

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Employer Contributions

No minimum funding contributions are required in 2011 under the Company s defined benefit plan. However, the Company made voluntary contributions to the plan of approximately $21 thousand for the three months ended March 31, 2011. Additionally, the Company has established two rabbi trusts to fund the Company s pension obligations under the non-qualified plan of the Chief Executive Officer and certain executive officers. The balance of these rabbi trust assets as of March 31, 2011 was approximately $13.5 million and is included in Investments on the Consolidated Balance Sheets.

Note 7. Guarantees

Warranty

ARRIS provides warranties of various lengths to customers based on the specific product and the terms of individual agreements. The Company provides for the estimated cost of product warranties based on historical trends, the embedded base of product in the field, failure rates, and repair costs at the time revenue is recognized. Expenses related to product defects and unusual product warranty problems are recorded in the period that the problem is identified. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers, the estimated warranty obligation could be affected by changes in ongoing product failure rates, material usage and service delivery costs incurred in correcting a product failure, as well as specific product failures outside of ARRIS baseline experience. If actual product failure rates, material usage or service delivery costs differ from estimates, revisions (which could be material) would be recorded to the warranty liability.

The Company offers extended warranties and support service agreements on certain products. Revenue from these agreements is deferred at the time of the sale and recognized on a straight-line basis over the contract period. Costs of services performed under these types of contracts are charged to expense as incurred, which approximates the timing of the revenue stream.

Information regarding the changes in ARRIS aggregate product warranty liabilities for the three months ended March 31, 2011 was as follows (in thousands):

Balance at December 31, 2010	$ 5,340
Accruals related to warranties (including changes in estimates)	530
Settlements made (in cash or in kind)	(536)
Balance at March 31, 2011	$ 5,334

Note 8. Restructuring Charges

ARRIS acquired restructuring accruals of approximately $0.7 million representing C-COR contractual obligations that related to excess leased facilities and equipment. In the fourth quarter of 2009, an adjustment of $1.5 million was made related to the sublease assumption for 2010-2014 given the current real estate market conditions. These payments will be paid over their remaining lease terms through 2014, unless terminated earlier.

		(in thousands)
Balance as of December 31, 2010	$	1,517
Payments		(93)
Balance as of March 31, 2011	$	1,424

Note 9. Inventories

Inventories are stated at the lower of average cost, approximating first-in, first-out, or market. The components of inventory were as follows, net of reserves (in thousands):

	March 31, 2011	December 31, 2010
Raw material	$ 17,894	$ 19,053
Work in process	3,758	4,176
Finished goods	84,135	78,534
Total inventories, net	$ 105,787	$ 101,763

Note 10. Property, Plant and Equipment

Property, plant and equipment, at cost, consisted of the following (in thousands):

	March 31, 2011	December 31, 2010
Land	$ 2,612	$ 2,612
Building and leasehold improvements	24,501	23,580
Machinery and equipment	144,207	139,381
	171,320	165,573
Less: Accumulated depreciation	(114,703)	(109,267)
Total property, plant and equipment, net	$ 56,617	$ 56,306

Note 11. Convertible Senior Notes

In 2006, the Company issued $276.0 million of 2% convertible senior notes due 2026. The notes are convertible, at the option of the holder, based on an initial conversion rate, subject to adjustment, of 62.1504 shares per $1,000 principal amount (which represents an initial conversion price of approximately $16.09 per share of our common stock), into cash up to the principal amount and, if applicable, shares of the Company s common stock, cash or a combination thereof. The notes may be converted during any calendar quarter in which the closing price of ARRIS common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 120% of the conversion price in effect at that time (which, based on the current conversion price, would be $19.31) and upon the occurrence of certain other events. Upon conversion, the holder will receive the principal amount in cash and an additional payment, in either cash or stock at the option of the Company. The additional payment will be based on a formula which calculates the difference between the initial conversion rate ($16.09) and the market price at the date of the conversion. As of May 5, 2011, the notes could not be converted by the holders thereof. Interest is payable on May 15 and November 15 of each year. The Company may redeem the notes at any time on or after November 15, 2013, subject to certain conditions. In addition, the holders may require the Company to purchase all or a portion of their convertible notes on or after November 13, 2013. There are no significant financial covenants related to the notes.

During 2010, ARRIS acquired $24.0 million principal amount of the notes, which had a book value, net of debt discount, of $20.0 million for approximately $23.3 million. The Company allocated $0.1 million to the reacquisition of the equity component of the notes. The Company also wrote off approximately $0.2 million of deferred finance fees associated with the portion of the notes acquired. As a result, the Company realized a gain of approximately $0.4 million on the retirement of the notes in 2010.

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ARRIS accounts for the liability and equity components of the notes separately. The Company is accreting the debt discount related to the equity component to non-cash interest expense over the estimated seven year life of the convertible notes, which represents the first redemption date of November 15, 2013 when the Company may redeem the notes at its election or the note holders may require their redemption. The equity and liability components related to the notes were as follows (in thousands):

	March 31, 2011	December 31, 2010
Carrying amount of the equity component	$ 48,527	$ 48,527
Principal amount of the liability component	$ 237,050	$ 237,050
Unamortized discount	(31,603)	(34,435)
Net carrying amount of the liability component	$ 205,447	$ 202,615

The following table presents the contractual interest coupon and the amortization of the discount on the equity component related to the notes during the three months ended March 31, 2011 and 2010 (in thousands):

	Three Months Ended March 31,	
	2011	2010
Contractual interest recognized	$ 1,185	$ 1,305
Amortization of discount	2,832	2,883

The effective annual interest rate on the debt component is 7.93%.

The Company paid approximately $7.8 million of finance fees related to the issuance of the notes. Of the $7.8 million, approximately $5.3 million was attributed to the debt component and $2.5 million was attributed to the equity component of the convertible debt instrument. The portion related to the debt component is being amortized over seven years. The remaining balance of unamortized financing costs from these notes as of March 31, 2011 and December 31, 2010 was $1.7 million and $1.9 million, respectively.

The Company has not paid cash dividends on its common stock since its inception.

Note 12. Comprehensive Income

Total comprehensive income represents the net change in stockholders equity during a period from sources other than transactions with stockholders. For ARRIS, the components of comprehensive income include the unrealized gain (loss) on marketable securities. The components of comprehensive income for the three months ended March 31, 2011 and 2010 are as follows (in thousands):

	Three Months Ended March 31,	
	2011	2010
Net income	$ 11,564	$ 18,991
Changes in the following equity accounts:		
Unrealized gain (loss) on marketable securities	852	(26)
Comprehensive income	$ 12,416	$ 18,965

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Note 13. Segment Information

The management approach has been used to present the following segment information. This approach is based upon the way the management of the Company organizes segments within an enterprise for making operating decisions and assessing performance. Financial information is reported on the basis that it is used internally by the chief operating decision maker for evaluating segment performance and deciding how to allocate resources to segments.

The *Broadband Communications Systems (BCS)* segment s product solutions include Headend and Subscriber Premises equipment that enable cable operators to provide Voice over IP, Video over IP and high-speed data services to residential and business subscribers.

The *Access, Transport & Supplies (ATS)* segment s product lines cover all components of a hybrid fiber coax network, including managed and scalable headend and hub equipment, optical nodes, radio frequency products, transport products and supplies.

The *Media & Communications Systems (MCS)* segment provides content and operations management systems, including products for Video on Demand, Ad Insertion, Digital Advertising, Service Assurance, Service Fulfillment and Mobile Workforce Management.

The table below represents information about the Company s reporting segments for the three months ended March 31, 2011 and 2010 (in thousands):

	BCS	ATS	MCS	Total
Three Months Ended March 31, 2011:				
Net sales	$206,630	$45,622	$15,184	$267,436
Gross margin	77,057	10,985	8,904	96,946
Amortization of intangible assets	397	5,259	3,288	8,944
Three Months Ended March 31, 2010:				
Net sales	$208,653	$42,243	$15,801	$266,697
Gross margin	94,674	9,702	8,135	112,511
Amortization of intangible assets	397	5,259	3,366	9,022

The Company s gross intangible assets and goodwill by reportable segment as of March 31, 2011 has not materially changed from December 31, 2010.

Note 14. Sales Information

The Company s two largest customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. Over the past year, certain customers beneficial ownership may have changed as a result of mergers and acquisitions. Therefore the revenue for ARRIS customers for prior periods has been adjusted to include the affiliates under common control. A summary of sales to these customers for the three months ended March 31, 2011 and 2010 are set forth below (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Comcast and affiliates	$72,933	$45,607
% of sales	27.3%	17.1%
Time Warner Cable and affiliates	$42,735	$41,065
% of sales	16.0%	15.4%

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ARRIS sells its products primarily in the United States. The Company s international revenue is generated from Asia Pacific, Europe, Latin America and Canada. The Asia Pacific market primarily includes China, Hong Kong, Japan, Korea, Singapore, and Taiwan. The European market primarily includes Austria, Belgium, France, Germany, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Great Britain, Ireland, Turkey, Russia, Romania, Hungry and Israel. The Latin American market primarily includes Argentina, Brazil, Chile, Columbia, Mexico, Peru, Puerto Rico, Ecuador, Honduras, Costa Rica, Panama, Jamaica, and Bahamas. For the three months ended March 31, 2011 and 2010, sales to international customers were approximately 29.0% and 40.8%, respectively, of total sales. International sales by region for the three months ended March 31, 2011 and 2010 were as follows (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Asia Pacific	$ 14,913	$ 11,875
Europe	23,037	31,385
Latin America	29,853	50,785
Canada	9,769	14,747
Total	$ 77,572	$ 108,792

Note 15. Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share (EPS) computations for the periods indicated (in thousands except per share data):

	Three Months Ended March 31,	
	2011	**2010**
Basic:		
Net income	$ 11,564	$ 18,991
Weighted average shares outstanding	122,297	125,967
Basic earnings per share	$ 0.09	$ 0.15
Diluted:		
Net income	$ 11,564	$ 18,991
Weighted average shares outstanding	122,297	125,967
Net effect of dilutive equity awards	3,435	4,008
Total	125,732	129,975
Diluted earnings per share	$ 0.09	$ 0.15

The Company has $237.1 million of convertible senior notes outstanding at March 31, 2011. Upon conversion, ARRIS will satisfy at least the principal amount in cash, rather than common stock. This reduced the potential earnings dilution to only include the conversion premium, which is the difference between the conversion price per share of common stock and the average share price. The average share price during the three months ended March 31, 2011 and 2010 was less than the conversion price of $16.09 and, consequently, did not result in dilution.

Excluded from the dilutive securities described above are employee stock options to acquire approximately 2.0 million shares and 2.8 million shares for the three months ended March 31, 2011 and 2010, respectively. These exclusions are made if the exercise price of these options is greater than the average market price of the common stock for the period, or if the Company has net losses, both of which have an anti-dilutive effect.

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Note 16. Income Taxes

During the three months ended March 31, 2011 and 2010, the Company recorded income tax expense (benefit) of $(0.2) million and $11.4 million, respectively. Below is a summary of the components of the tax expense (benefit) in each period (in millions, except for percentages):

	Three Months Ended March 31,					
	2011			2010		
	Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate	Income Before Tax	Income Tax Expense (Benefit)	Effective Tax Rate
Non-discrete items	$ 11,325	$ 3,344	29.5%	$ 30,355	$ 10,142	33.4%
Discrete tax events						
Valuation allowances, uncertain tax positions		(3,583)			1,222	
Total	$ 11,325	$ (239)	(2.1)%	$ 30,355	$ 11,364	37.4%

During the first quarter of 2011, the Company identified $4.0 million of discrete tax benefits relating to the release of valuation allowances against state deferred tax assets, which was partially offset by $0.4 million of additional liabilities related to tax positions which may not be fully sustained upon examination.

During the first quarter of 2010, the Company identified $1.2 million of discrete tax adjustments relating to state deferred tax assets.

Note 17. Repurchases of ARRIS Common Stock

During the first quarter of 2009, ARRIS Board of Directors authorized a plan for the Company to repurchase up to $100 million of the Company s common stock. The Company did not repurchase any shares under the plan during 2009.

In 2010, ARRIS repurchased 6.8 million shares of the Company s common stock at an average price of $10.24 per share for an aggregate consideration of approximately $69.3 million.

During the first three month of 2011, ARRIS did not repurchase any shares under the plan. However, in April 2011, ARRIS repurchased 1.7 million shares of the Company s common stock at an average price of $12.34 per share, for an aggregate consideration of approximately $21.4 million.

As of May 5, 2011, the remaining authorized amount for future repurchases was $9.3 million.

Note 18. Contingencies

From time to time, ARRIS is involved in claims, disputes, litigation or legal proceedings incidental to the ordinary course of its business, such as intellectual property disputes, contractual disputes, employment matters and environmental proceedings. It is not possible to reasonably estimate the probability of an adverse outcome or the potential loss associated with any such items.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

We are a global communications technology company, headquartered in Suwanee, Georgia. We operate in three business segments, Broadband Communications Systems (BCS), Access, Transport & Supplies (ATS), and Media & Communications Systems (MCS). A detailed description of each segment is contained in Our Principal Products in our Form 10-K for the year ended December 31, 2010. We specialize in integrated broadband network solutions that include products, systems and software for content and operations management (including video on demand, or VOD), and professional services. We are a leading developer, manufacturer and supplier of telephony, data, video, construction, rebuild and maintenance equipment for the broadband communications industry. In addition, we are a leading supplier of infrastructure products used by cable system operators to build-out and maintain hybrid fiber-coaxial (HFC) networks. We provide our customers with products and services that enable reliable, high speed, two-way broadband transmission of video, telephony, and data.

Our Strategy and Key Highlights

Our long-term business strategy, Convergence Enabled, includes the following key elements:

- Maintain a strong capital structure, mindful of our debt (which is likely to be required to be repaid in 2013), share repurchase opportunities and other capital needs including mergers and acquisitions.
- Grow our current business into a more complete portfolio including a strong video product suite.
- Continue to invest in the evolution toward enabling true network convergence onto an all IP platform.
- Continue to expand our product/service portfolio through internal developments, partnerships and acquisitions.
- Expand our international business and begin to consider opportunities in markets other than cable.
- Continue to invest in and evolve the ARRIS talent pool to implement these strategies.

To fulfill our strategy, we develop technology, facilitate its implementation, and enable operators to put their subscribers in control of their entertainment, information, and communication needs. Through a set of business solutions that respond to specific market needs, we are integrating our products, software, and services solutions to work with our customers as they address Internet Protocol telephony deployment, high speed data deployment, high definition television content expansion, on demand video rollout, operations management, network integration, and business services opportunities.

Below are some key highlights relative to the three months ended March 31, 2011:

Financial Highlights

- Sales in the first quarter of 2011 were $267.4 million as compared to $266.7 million in the same period in 2010. While the sales are relatively flat year over year, we have experienced a change in mix which has impacted our gross margin.
- Gross margin percentage was 36.3% in the first quarter of 2011, which compares to 42.2% in the first quarter of 2010. The decline reflects a change in mix with higher sales of our EMTAs (which have lower than average margins) and lower sales of CMTSs (which have higher than average margins). It also reflects lower market pricing. We anticipate that our BCS margins will improve later in the year with increased sales of our CMTS line card capacity upgrade, which have higher margins.
- Total operating expenses (excluding amortization of intangible assets) in the first quarter of 2011 were $72.9 million, up $3.4 million year over year. Research and development expenses increased $1.7 million as a result of higher compensation costs. Selling, general, and administrative expenses increased $1.7 million as a result of higher variable compensation costs and higher legal fees. We anticipate operating expense will increase in the second quarter of 2011 by $2 million to $3 million as a result of higher start up costs related to

new product introductions and annual merit increases. The higher start up costs should dissipate in the second half of 2011.

We ended the first quarter of 2011 with $619.6 million of cash, cash equivalents and short-term investments. We used approximately $3.6 million of cash for operating activities in the first quarter of 2011, predominately as the result of an increase in accounts receivable and a decrease in accounts payable.

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In the first quarter of 2011, we recorded a net decrease to our deferred tax valuation allowances of approximately $3.6 million which reduced our income tax expense. As a result of legal entity restructuring and simplifications effective on January 1, 2011, we concluded that we will be able to utilize certain state NOLs in the future.

Product Line Highlights

Broadband Communications Systems

- CMTS
  - Continued strong demand for increased network capacity, shipping a record number of downstream ports, up 36% from the previous high in 4Q10 to almost 63 thousand ports in the first quarter of 2011
  - Ongoing pricing adjustments to remain competitive and in anticipation of the introduction of new higher density downstream line cards starting in the second quarter of 2011
  - Excellent progress with initial field trials of new software release that enables operators to double the capacity of existing ARRIS C4 CMTS equipment
  - Good progress on development of next generation Converged Edge Router CMTS product that will enable smooth transition of legacy video networks to IP
- Video Processing
  - Announcement of a new video processing platform supporting MPEG4 encoding, transcoding, and adaptive streaming for IP-based video distribution
- Whole House Solution
  - Extensive field trials underway with lead customers of our new Multimedia Gateway solution. We anticipate first product revenue in the second quarter of 2011.
- CPE
  - Approximately 1.4 million CPE units were shipped in the first quarter of 2011. Shipments of DOCSIS 3.0 CPE decreased to 29% of the total unit shipments as compared to 38% in the fourth quarter of last year. DOCSIS2.0 CPE continues to be a large portion of the MSO purchase volumes primarily due to lower costs vs. the latest DOCSIS3.0 technology.
  - Maintained number one EMTA market share for 25 consecutive quarters (source: Infonetics)
  - The first quarter 2011 was our strongest quarter to date for the sales of multiline business services terminals.
  - Good progress on the development of our IP Multimedia gateway including the shipment of first lab trial units.

Access, Transport & Supplies

- Increasing demand in the ATS business unit led by increases in Professional Services
- Professional Services growth related to activities in Cell Tower Backhaul, Metro-E and Telco Solutions
- MSO s increasing investments in node segmentation as a cost effective vehicle to provide more capacity per subscriber
  - Multi-wavelength optics continue to gain traction in support of these MSO investments

- § Investments by ARRIS to take advantage of technology improvements and component cost reductions continue to position us well with the MSO s
- o A Resellers agreement was signed with Ruckus Wireless, a premier provider of WiFi solutions to Telco s, Institutions and MSOs.

Media & Communications Systems

- o Strong bookings for Assurance in the quarter reflecting continued focus by our MSO customers on operating expense reduction and end-user satisfaction

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- o Modest wins for our On Demand product as we continue to displace competitors in the Ad Insertion segment

- o Announcement of a new high density server platform, XMS-Flex, applicable to managed Content Distribution Networks (CDNs)

Non-GAAP Measures

As part of our ongoing review of financial information related to our business, we regularly use Non-GAAP measures, in particular Non-GAAP earnings per share, as we believe they provide a meaningful insight into our business and trends. We also believe that these Non-GAAP measures provide readers of our financial statements with useful information and insight with respect to the results of our business. However, the presentation of Non-GAAP information is not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. Below are tables for the three months ended March 31, 2011 and 2010 which detail and reconcile GAAP and Non-GAAP earnings per share:

	For the Three Months Ended March 31, 2011					
(in thousands, except per share data)	Gross Margin	Operating Expense	Operating Income	Other (Income) Expense	Tax Expense (Benefit)	Net Income (Loss)
GAAP	96,946	81,822	15,124	3,799	(239)	11,564
Stock compensation expense	437	(4,847)	5,284			5,284
Amortization of intangible assets		(8,944)	8,944			8,944
Non-cash interest expense				(2,832)		2,832
Tax related to items above					5,024	(5,024)
Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items					3,583	(3,583)
Non-GAAP	97,383	68,031	29,352	967	8,368	20,017
GAAP net income per share diluted						$ 0.09
Non-GAAP net income per share diluted						$ 0.16
GAAP weighted average common shares diluted						125,732
Non-GAAP weighted average common shares diluted						125,732

	For the Three Months Ended March 31, 2010					
(in thousands, except per share data)	Gross Margin	Operating Expense	Operating Income	Other (Income) Expense	Income Tax Expense	Net Income (Loss)

GAAP	112,511	78,556	33,955	3,600	11,364	18,991
Stock compensation expense	433	(4,088)	4,521			4,521
Acquisition costs, restructuring, and integration costs		(52)	52			52
Amortization of intangible assets		(9,021)	9,021			9,021
Non-cash interest expense				(2,883)		2,883
Tax related to items above					5,505	(5,505)
Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items					(1,222)	1,222
Non-GAAP	112,944	65,395	47,549	717	15,647	31,185
GAAP net income per share diluted						$ 0.15
Non-GAAP net income per share diluted						$ 0.24
GAAP weighted average common shares diluted						129,975
Non-GAAP weighted average common shares diluted						129,975

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In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items is useful in understanding the trends and managing our operations. We provide these supplemental non-GAAP measures in order to assist the investment community to see ARRIS through the eyes of management, and therefore enhance understanding of ARRIS operating performance. These adjustments consist of:

Stock compensation expense ARRIS records non-cash compensation expense related to grants of options and restricted stock. Depending upon the size, timing and the terms of the grants, this non-cash compensation expense may vary significantly.

Acquisition costs, restructuring, and integration costs although these items or similar items might recur, they are of a nature and magnitude that identifying them separately provides investors with a greater ability to project ARRIS future performance.

Amortization of intangibles non-cash amortization of the intangibles related to our acquisitions.

Non-cash interest expense ARRIS records non-cash interest expense related to the convertible debt. Disclosing the non-cash component provides investors with the information regarding interest that will not be paid out in cash.

Adjustments of income taxes valuation allowances, R&D credits, and other discrete tax items During the first quarter of 2011, a net tax benefit of approximately $3.6 million was recorded for state valuation allowances. During the first quarter of 2010, ARRIS recorded a discrete tax expense of $1.2 million related to state deferred tax assets.

Significant Customers

The Company s two largest customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. Over the past year, certain customers beneficial ownership may have changed as a result of mergers and acquisitions. Therefore the revenue for ARRIS customers for prior periods has been adjusted to include the affiliates under common control. A summary of sales to these customers for the three months ended March 31, 2011 and 2010 are set forth below (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Comcast and affiliates	$72,933	$45,607
% of sales	27.3%	17.1%
Time Warner Cable and affiliates	$42,735	$41,065
% of sales	16.0%	15.4%

Comparison of Operations for the Three Months Ended March 31, 2011 and 2010

Net Sales

The table below sets forth our net sales for the three months ended March 31, 2011 and 2010, for each of our segments (in thousands):

	Net Sales			
	Three Months Ended March 31,		**Increase (Decrease) 2011 vs. 2010**	
	2011	2010	$	%
Business Segment:				
Broadband Communications Systems	$ 206,630	$ 208,653	$ (2,023)	(1.0)%
Access, Transport & Supplies	45,622	42,243	3,379	8.0%

Media & Communications Systems	15,184	15,801	(617)	(3.9)%
Total sales	$ 267,436	$ 266,697	$ 739	0.3%

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The table below sets forth our domestic and international sales for the three months ended March 31, 2011 and 2010 (in thousands):

	Net Sales			
	Three Months Ended March 31,		Increase (Decrease) 2011 vs. 2010	
	2011	2010	$	%
Domestic sales	$ 189,864	$ 157,905	$ 31,959	20.2%
International sales	77,572	108,792	(31,220)	(28.7)%
Total sales	$ 267,436	$ 266,697	$ 739	0.3%

Broadband Communication Systems Net Sales 2011 vs. 2010

During the three months ended March 31, 2011, sales in our BCS segment decreased by approximately 1.0% as compared to the same period in 2010. Although we continue to experience strong demand for our CMTS products, we have reduced some of our pricing on these products in order to remain competitive, resulting in lower revenue. The decline in CMTS was partially offset by higher CPE sales in the quarter.

Access, Transport & Supplies Net Sales 2011 vs. 2010

During the three months ended March 31, 2011, sales in our Access, Transport and Supplies segment increased by approximately 8.0% as compared to the same period in 2010. The increase for the quarter primarily reflects higher professional services sales.

Media & Communication Systems Net Sales 2011 vs. 2010

During the three months ended March 31, 2011, sales in our Media & Communications Systems segment decreased by approximately 3.9% as compared to the same period in 2010.

Gross Margin

The table below sets forth our gross margin for the three months ended March 31, 2011 and 2010, for each of our reporting segments (in thousands):

	Gross Margin $			
	Three Months Ended March 31,		Increase (Decrease) 2011 vs. 2010	
	2011	2010	$	%
Business Segment:				
Broadband Communications Systems	$ 77,057	$ 94,674	$ (17,617)	(18.6)%
Access, Transport & Supplies	10,985	9,702	1,283	13.2%
Media & Communications Systems	8,904	8,135	769	9.5%
Total	$ 96,946	$ 112,511	$ (15,565)	(13.8)%

The table below sets forth our gross margin percentages for the three months ended March 31, 2011 and 2010, for each of our business segments:

	Gross Margin %		
	Three Months Ended March 31,		Percentage Point Increase (Decrease)
	2011	2010	2011 vs. 2010
Business Segment:			

Broadband Communications Systems	37.3%	45.4%	(8.1)
Access, Transport & Supplies	24.1%	23.0%	1.1
Media & Communications Systems	58.6%	51.5%	7.1
Total	36.3%	42.2%	(5.9)

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Broadband Communications Systems Gross Margin 2011 vs. 2010

Broadband Communications Systems segment gross margin percentage and dollars decreased during the three months ended March 31, 2011 as compared to the same period in 2010. The decrease reflects lower market pricing on our CMTS products, and also a product mix change as we had higher EMTA revenue and lower CMTS revenue (EMTA products have a lower gross margin than CMTS products).

Access, Transport & Supplies Gross Margin 2011 vs. 2010

The Access, Transport & Supplies segment gross margin dollars and percentage increased during the three months ended March 31, 2011 as compared to the same period in 2010. These increases were driven by higher sales and product mix.

Media & Communications Systems Gross Margin 2011 vs. 2010

Media & Communications Systems segment gross margin dollars and percentage increased during the three months ended March 31, 2011. The increase reflects higher Assurance product sales which have higher gross margins.

Operating Expenses

The table below provides detail regarding our operating expenses (in thousands):

	Operating Expenses			
	Three Months Ended March 31,		Increase (Decrease) 2011 vs. 2010	
	2011	2010	$	%
Selling, general, and administrative	$ 36,838	$ 35,118	$ 1,720	4.9%
Research and development	36,040	34,365	1,675	4.9%
Restructuring		52	(52)	(100.0)%
Amortization of intangible assets	8,944	9,021	(77)	(0.9)%
Total	$ 81,822	$ 78,556	$ 3,266	4.2%

Selling, General, and Administrative, or SG&A, Expenses

The year over year increase in SG&A expenses reflects higher variable compensations costs, merit increases, and higher legal costs.

Research & Development, or R&D, Expenses

The year over year increase in R&D expenses reflects increased headcount, as we continued to aggressively invest in R&D. The increase is also the result of merit increases implemented at the beginning of the second quarter of 2010.

Restructuring Charges

On a quarterly basis, we review our existing restructuring accruals and make adjustments if necessary. For the three months ended March 31 2010, an adjustment of $52 thousand was made to increase the restructuring accrual. No adjustments were made during the three months ended March 31, 2011.

Amortization of Intangibles

Intangibles amortization expense for the three months ended March 31, 2011 and 2010 was $8.9 million and $9.0 million, respectively. Our intangible expense is related to the acquisitions of, Digeo Inc. in October 2009, EG Technologies in September 2009, Auspice Corporation in August 2008 and C-COR Incorporated in December 2007.

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Impairment of Goodwill

Goodwill relates to the excess of cost over the fair value of net assets resulting from an acquisition. Our goodwill is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. During the three months ended March 31, 2011 and 2010, no indicators of impairment existed and, therefore, no impairment charges were recorded.

Based on our most recent annual goodwill impairment assessment performed as of October 1, 2010, we determined that our BCS, ATS, and MCS reporting units were not at risk of failing step one of the goodwill impairment test. However, our MCS reporting unit valuation included assumptions and estimates of cash flows, including probability weighted cash flows conditional upon favorable outcome of litigation we are currently pursuing against another company (see Part II, Item 1, Legal Proceedings). Excluding the discrete contingent cash flows, our MCS reporting unit was at risk of failing step one of the goodwill impairment test, and is therefore at risk of a future impairment in the event of significant unfavorable changes in the forecasted cash flows or the key assumptions used in our analysis, including the weighted average cost of capital (discount rate) and growth rates utilized in the discounted cash flow analysis. Further, upon a favorable settlement and recovery or an unfavorable outcome with no settlement proceeds, no future value would exist related to such contingent cash flows, and as a result the MCS reporting unit may be at risk of failing step one of the impairment test. As of March 31, 2011, the litigation had yet to be resolved.

The following table sets forth the information regarding our MCS reporting unit as of October 1, 2010 (annual goodwill impairment testing date), including key assumptions (dollars in thousands):

	Key Assumptions		% Fair Value Exceeds Carrying Value as of October 1, 2010		Goodwill as of October 1, 2010	
	Discount Rate	Terminal Growth Rate	Inclusive of contingent cash flows	Excluding contingent cash flows	Amount	Percent of Total Assets
MCS	16.0%	3.0%	27.1%	4.2%	$41,875	16.2%

Assumptions and estimates about future cash flows and discount rates are complex and often subjective. They are sensitive to changes in underlying assumptions and can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Our assessment includes significant estimates and assumptions including the timing and amount of future discounted cash flows, the discount rate and the perpetual growth rate used to calculate the terminal value.

Our discounted cash flow analysis included projected cash flows over a ten-year period, using our three-year business plans plus an additional seven years of projected cash flows based on the most recent three-year plan. These forecasted cash flows took into consideration management s outlook for the future and were compared to historical performance to assess reasonableness. A discount rate was applied to the forecasted cash flows. The discount rate considered market and industry data, as well as the specific risk profile of the reporting unit. A terminal value was calculated, which estimates the value of annual cash flow to be received after the discrete forecast periods. The terminal value was based upon an exit value of annual cash flow after the discrete forecast period in year ten.

Examples of events or circumstances that could reasonably be expected to negatively affect the underlying key assumptions and ultimately impact the estimated fair value of the aforementioned reporting unit may include such items as the following:

- a prolonged decline in capital spending for constructing, rebuilding, maintaining, or upgrading broadband communications systems;

- rapid changes in technology occurring in the broadband communication markets which could lead to the entry of new competitors or increased competition from existing competitors that would adversely affect

our sales and profitability;

the concentration of business we receive from several key customers, the loss of which would have a material adverse effect on our business;

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continued consolidation of our customers base in the telecommunications industry could result in delays or reductions in purchases of our products and services, if the acquirer decided not to continue using us as a supplier;

new products and markets currently under development may fail to realize anticipated benefits;

changes in business strategies affecting future investments in businesses, products and technologies to complement or expand our business could result in adverse impacts to existing business and products;

volatility in the capital (equity and debt) markets, resulting in a higher discount rate; and

legal proceeding settlements and/or recoveries, and its affect on future cash flows.

As a result, there can be no assurance that the estimates and assumptions made for purposes of the annual goodwill impairment test will prove to be accurate predictions of the future. Although management believes the assumptions and estimates made are reasonable and appropriate, different assumptions and estimates could materially impact the reported financial results. The table below provides sensitivity analysis related to the impact of each of the key assumptions, on a standalone basis, on the resulting percentage change in fair value of our MCS reporting unit as of October 1, 2010:

	Percentage Reduction in Fair Value (excluding contingent cash flows)		
	Assuming Hypothetical 10% Reduction in cash flows	Assuming Hypothetical 1% increase in Discount Rate	Assuming Hypothetical 1% decrease in Terminal Growth Rate
MCS	-6.0%	-6.2%	-2.2%

Other Expense (Income)

Interest Expense

Interest expense for the three months ended March 31, 2011 and 2010 was $4.2 million and $4.4 million respectively. Interest expense reflects the amortization of deferred finance fees, the non-cash interest component of our convertible subordinated notes, interest paid on the notes, capital leases and other debt obligations.

Interest Income

Interest income during the three months ended March 31, 2011 and 2010 was $0.8 million and $0.4 million, respectively. The income reflects interest earned on cash, cash equivalents and short-term investments.

Loss (Gain) on Foreign Currency

During the three months ended March 31, 2011 and 2010, we recorded a foreign currency loss (gain) of approximately $0.9 million and $(0.3) million, respectively. We have certain international customers who are billed in their local currency, primarily the euro. To mitigate the volatility related to fluctuations in the foreign exchange rates, we may enter into various foreign currency contracts. The loss (gain) on foreign currency is driven by the fluctuations in the foreign currency exchanges rates, primarily the euro.

Other Expense (Income)

Other expense (income) for the three months ended March 31, 2011 and 2010 was $(0.1) million and $(42) thousand, respectively.

Income Tax Expense (Benefit)

In the three months ended March 31, 2011 and 2010, we recorded income tax expense (benefit) of $(0.2) million and $11.4 million, respectively. In the first quarter of 2011, the Company implemented certain legal entity changes to

reduce complexity and simplify our corporate organizational structure and tax accounting provision process. As a result, approximately $3.6 million of valuation allowances related to state deferred tax assets, primarily net operating losses, were reversed as we concluded it was more likely than not that we will now be able

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to utilize the deferred tax assets in future periods. In the first quarter of 2010, adjustments to certain valuation allowances resulted in an expense of $1.2 million. The overall effective income tax rate, excluding all discrete items, for the three months ended March 31, 2011, was 29.5%, as compared to 33.4% for the same period in 2010.
The Company anticipates that the effective income tax rate for full year 2011, excluding discrete items, will be approximately 30%.

Financial Liquidity and Capital Resources

Overview

One of our key strategies is to maintain and improve our capital structure. The key metrics we focus on are summarized in the table below:

Liquidity & Capital Resources Data

	Three Months Ended March 31,	
	2011	2010
	(in thousands, except DSO and turns)	
Key Working Capital Items		
Cash provided by (used in) operating activities	$ (3,571)	$ 48,210
Cash, cash equivalents, and short-term investments	$ 619,609	$ 661,056
Accounts receivable, net	$ 149,976	$ 139,207
Days Sales Outstanding (DSOs)	47	48
Inventory	$ 105,787	$ 79,907
Inventory turns	6.6	7.0
Convertible notes at face value	$ 237,050	$ 261,050
Convertible notes at book value	$ 205,447	$ 214,131
Capital Expenditures	$ 6,251	$ 4,654

In managing our liquidity and capital structure, we have been and are focused on key goals, and we have and will continue in the future to implement actions to achieve them. They include:

- Liquidity ensure that we have sufficient cash resources or other short term liquidity to manage day to day operations

- Growth implement a plan to ensure that we have adequate capital resources, or access thereto, fund internal growth and execute acquisitions while retiring our convertible notes in a timely fashion.

- Share repurchases opportunistically repurchase our common stock.

Accounts Receivable & Inventory

We use the number of times per year that inventory turns over (based upon sales for the most recent period, or turns) to evaluate inventory management, and days sales outstanding, or DSOs, to evaluate accounts receivable management. Accounts receivable increased and DSOs decreased slightly during the three months of 2011 as compared to 2010. Looking forward, we do not anticipate a material change in DSOs, although it is possible that our DSOs may increase if the international component of our business increases as customers internationally typically have longer payment terms.

Inventory at the end of the first quarter of 2011 was $25.9 million higher than the end of the first quarter of 2010. Inventory turns during the first three months of 2011 were 6.6 as compared to 7.0 in the same period of 2010. The increase in inventory was primarily related to an increase in BCS inventory levels to ensure adequate supply.

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Summary of Current Liquidity Position and Potential for Future Capital Raising

We believe our current liquidity position, where we have approximately $620 million of cash, cash equivalents, and short-term investments on hand as of March 31, 2011, together with the prospects for continued generation of cash from operations are adequate for our short- and medium-term business needs. We may in the future elect to repurchase additional shares of our common stock or convertible notes. In addition, a key part of our overall long-term strategy may be implemented through additional acquisitions, and a portion of these funds may be used for that purpose. Should our available funds be insufficient for those purposes, it is possible that we will raise capital through private or public, share or debt offerings.

Commitments

Our contractual obligations are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010. There has been no material change to our contractual obligations during the first three months of 2011.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

Cash Flow

Below is a table setting forth the key line items of our Consolidated Statements of Cash Flows (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Cash provided by (used in) operating activities	$(3,571)	$ 48,210
Cash provided by (used in) investing activities	379	(44,750)
Cash provided by (used in) financing activities	8,818	(3,981)
Net increase (decrease) in cash	$ 5,626	$ (521)

Operating Activities:

Below are the key line items affecting cash provided by operating activities (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Net income	$ 11,564	$ 18,991
Adjustments to reconcile net income to cash provided by operating activities	11,145	15,143
Net income including adjustments	22,709	34,134
(Increase) decrease in accounts receivable	(24,043)	4,206
(Increase) decrease in inventory	(4,024)	15,944
Decrease in accounts payable and accrued liabilities	(7,048)	(24,935)
All other net	8,835	18,861
Cash provided by (used in) operating activities	$ (3,571)	$ 48,210

Net income, including adjustments, decreased $11.4 million during the first three months of 2011 as compared to 2010, primarily due to lower gross margins in 2011.

Accounts receivable increased by $24.0 million during the first three months of 2011. This increase was primarily related to our billing pattern during the quarter, in which higher billing occurred toward the end of the period.

Inventory increased by $4.0 million during the first three months of 2011.

Accounts payable and accrued liabilities decreased by $7.0 million. This was the result of several timing factors, and also impacted by the payout of annual bonuses during the quarter.

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All other accounts, net, includes the changes in other receivables, income taxes payable (recoverable), and prepaids. The net change during the first three months of 2011 of approximately $8.8 million related primarily to the changes in prepaids and other, as well as changes in income tax accounts.

Investing Activities:

Below are the key line items affecting investing activities (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Purchases of property, plant and equipment	$ (6,251)	$ (4,654)
Cash proceeds from sale of property, plant and equipment	42	240
Purchases of investments	(99,361)	(42,436)
Sales of investments	105,949	2,100
Cash provided by (used in) investing activities	$ 379	$(44,750)

Purchases of Property, Plant and Equipment This represents capital expenditures are mainly for test equipment, laboratory equipment, and computing equipment. We anticipate investing approximately $25 million in fiscal year 2011.

Cash Proceeds from Sale of Property, Plant and Equipment This represents the cash proceeds we received from the sale of property, plant and equipment.

Purchases and Sales of Investments **-** These represent purchases and sales of securities.

Financing Activities:

Below are the key line items affecting our financing activities (in thousands):

	For the Three Months Ended March 31,	
	2011	2010
Payment of debt obligations	$	$ (37)
Repurchase of common stock		(3,059)
Excess income tax benefits from stock-based compensation plans	3,700	2,486
Repurchase of shares to satisfy employee tax withholdings	(8,245)	(5,993)
Proceeds from issuance of common stock	13,363	2,622
Cash provided by (used in) financing activities	$ 8,818	$(3,981)

Payment of Debt Obligations This represents the payments related to a short term loan to the Pennsylvania Industrial Development Authority (PIDA) for the cost of expansion of the facility in State College, Pennsylvania. The debt was repaid in 2010.

Repurchase of Common Stock During the first quarter of 2009, ARRIS Board of Directors authorized a plan for the Company to repurchase up to $100 million of the Company s common stock. ARRIS repurchased 250 thousand shares under the 2009 Plan of the Company s common stock at an average price of $12.22 per share for an aggregate consideration of approximately $3.1 million during the first quarter of 2010.

Excess Income Tax Benefits from Stock-Based Compensation Plans This represents the cash that otherwise would have been paid for income taxes if increases in the value of equity instruments also had not been deductible in determining taxable income.

Repurchase of Shares to Satisfy Tax Withholdings This represents the minimum shares withheld to satisfy the tax withholding when restricted stock vests.

Proceeds from Issuance of Common Stock, Net Represents cash proceeds related to the exercise of employee stock options, offset by expenses paid related to issuance of common stock.

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Interest Rates

As of March 31, 2011, we did not have any floating rate indebtedness or outstanding interest rate swap agreements.

Foreign Currency

A significant portion of our products are manufactured or assembled in China, Ireland, Mexico, Taiwan, and other foreign countries. Further, we have a manufacturing facility in Mexico. Our sales into international markets have been and are expected in the future to be an important part of our business. These foreign operations are subject to the usual risks inherent in conducting business abroad, including risks with respect to currency exchange rates, economic and political destabilization, restrictive actions and taxation by foreign governments, nationalization, the laws and policies of the United States affecting trade, foreign investment and loans, and foreign tax laws.

We have certain international customers who are billed in their local currency. We use a hedging strategy and enter into forward or currency option contracts based on a percentage of expected foreign currency revenues. The percentage can vary, based on the predictability of the revenues denominated in the foreign currency.

Financial Instruments

In the ordinary course of business, we, from time to time, will enter into financing arrangements with customers. These financial arrangements include letters of credit, commitments to extend credit and guarantees of debt. These agreements could include the granting of extended payment terms that result in longer collection periods for accounts receivable and slower cash inflows from operations and/or could result in the deferral of revenue.

ARRIS executes letters of credit in favor of certain landlords and vendors to guarantee performance on lease and insurance contracts. Additionally, we have cash collateral account agreements with our financial institutions as security against potential losses with respect to our foreign currency hedging activities. The letters of credit and cash collateral accounts are reported as restricted cash. As of March 31, 2011 and December 31, 2010, we had approximately $4.2 million and $4.9 million outstanding, respectively, of cash collateral.

Cash, Cash Equivalents, and Short-Term Investments

Our cash and cash equivalents (which are highly-liquid investments with an original maturity of three months or less) are primarily held in money market funds that pay either taxable or non-taxable interest. We hold short-term investments consisting of debt securities classified as available-for-sale, which are stated at estimated fair value. These debt securities consist primarily of commercial paper, certificates of deposits, and U.S. government agency financial instruments.

From time to time, we hold certain investments in the common stock of publicly-traded companies, which are classified as available-for-sale. As of March 31, 2011 and December 31, 2010 our holdings in these investments were $6.4 million and $5.8 million, respectively. Changes in the market value of these securities are recorded in other comprehensive income and gains or losses on related sales of these securities are recognized in income (loss).

ARRIS holds an investment in a private company. This investment is recorded using the cost method, which was $4.0 million as of March 31, 2011 and December 31, 2010. Due to the fact the investment is in a private company, we are exempt from estimating the fair value on an interim basis. However, ARRIS is required to estimate the fair value if there has been an identifiable event or change in circumstance that may have a significant adverse effect on the fair value of the investment. Each quarter, we evaluate our investment for any other-than-temporary impairment, by reviewing the current revenues, bookings and long-term plan of the private company.

See Note 4 of Notes to the Consolidated Financial Statements for disclosures related to the fair value of our investments.

We have a deferred compensation plan that was available to certain current and former officers and key executives of C-COR. During 2008, this plan was merged into a new non-qualified deferred compensation plan which is also available to our key executives. Employee compensation deferrals and matching contributions are

held in a rabbi trust, which is a funding vehicle used to protect the deferred compensation from various events (but not from bankruptcy or insolvency).

Additionally, we previously offered a deferred compensation arrangement to certain senior employees. As of December 31, 2004, the plan was frozen and no further contributions are allowed. The deferred earnings are invested in a rabbi trust.

We also have a deferred retirement salary plans, which were limited to certain current or former officers of C-COR. We hold investments to cover the liability.

ARRIS also funds its nonqualified defined benefit plan for certain executives in a rabbi trust.

Capital Expenditures

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS capital expenditures were $6.3 million in the first three months of 2011 as compared to $4.7 million in the first three months of 2010. Management expects to invest approximately $25 million in capital expenditures for the fiscal year 2011.

Critical Accounting Policies and Estimates

The accounting and financial reporting policies of ARRIS are in conformity with U.S. generally accepted accounting principles, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management has discussed the development and selection of the Company s critical accounting estimates with the audit committee of the Company s Board of Directors and the audit committee has reviewed the Company s related disclosures.

Our critical accounting policies and estimates are disclosed in our Form 10-K for the year ended December 31, 2010, as filed with the SEC. Our critical accounting estimates have not changed in any material respect during the three months ended March 31, 2011.

Item 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* Our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report (the Evaluation Date). Based on that evaluation, such officers concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective as contemplated by the Act.

(b) *Changes in Internal Control over Financial Reporting*. Our principal executive officer and principal financial officer evaluated the changes in our internal control over financial reporting that occurred during the most recent fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there had been no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, ARRIS is involved in claims, disputes, litigation or legal proceedings incidental to the ordinary course of its business, such as intellectual property disputes, contractual disputes, employment matters and environmental proceedings. Also, suits may be brought against ARRIS customers that, in turn, may ask ARRIS for indemnification. Except as described below, ARRIS is not party to any proceedings that are, or reasonably could be expected to be, material to its business, results of operations or financial condition.

Pragmatus VOD LLC v. MSOs. Case 1:11-cv-00070-UNA, District of Delaware. In January 2011, Pragmatus filed suit against most MSOs alleging infringement of two US patents, nos. 5,581,479 and 5,636,139, related to VOD products and services. The complaint has been served on several of our customers, and certain of the defendants have requested that we provide indemnification. We are in the process of reviewing the patents. The complaint requests unspecified damages, although to-date no evidence of damages has been introduced. All parties to the case have answered the complaint and a pre-trial conference is set for June 8, 2011. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

Ceres Comm. v. MSOs, Telcos, and others. Case 1:99-mc-09999, District of Delaware. In August and December 2010, Ceres filed suit against 23 and 13 companies, respectively, which included the major MSOs, Telcos and others, alleging infringement of two US patents, nos. 5,774,526 and 7,149,252. Certain of our customers that are defendants have requested that we provide indemnification. The complaint requests unspecified damages, although to-date no evidence of damages has been introduced. The parties held a scheduling conference in April 2011, and Skype Inc. recently moved to disqualify the plaintiff s attorney. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

PACid v. BestBuy et al. Civil Action No. 10-cv-00370, Eastern District of Texas. In July 2010, PACid filed suit against 87 companies, including ARRIS, alleging infringement of two US patents, nos. 5963646 and 6049612, related to methods of encryption. The complaint requests unspecified damages. To date, no evidence of damages has been introduced. ARRIS filed an answer generally denying the allegations. In March 2011, the Court issued an order consolidating this case with previously filed PACid cases. It is premature to assess the likelihood of a favorable outcome however ARRIS believes that its suppliers of the relevant chips have obtained licenses with PACid which would protect ARRIS. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

ARRIS v. British Telecom & British Telecom v. Cox and Cable On**e**. 1:09-CV-0671, U.S. District Court, Northern District of Georgia; C.A. No. 10-658 (SLR), U.S. District Court, District of Delaware; 1:11-CV-01231, U.S. District Court, Northern District of Georgia. In March 2009, ARRIS filed suit against British Telecom (BT) seeking to invalidate four BT patents, nos. 5,142,532, 5,526,350, 6,538,989 and 6,665,264, and seeking a declaration that neither ARRIS products, nor their use by ARRIS customers, infringe the four BT patents related to various network features. This suit was in response to the assertion by BT (via its agent, IPValue), that ARRIS products and/or their use by ARRIS customers infringed the four BT patents. In August 2010, BT sued Cox and Cable One alleging infringement of the four BT patents. Cox and Cable One have requested ARRIS (and other suppliers) to provide indemnification. The complaint requests unspecified damages. In April 2011, ARRIS filed suit against BT seeking a finding of non-infringement or invalidity on four additional BT patents, nos. 5,790,643, 5,923,247, 6,205,216 and 6,473,742. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Charter and Cox, pay royalties and/or cease utilizing certain technology.

ARRIS v. SeaChange Int. (previously *nCube v. SeaChange*). CA No. 01-011 (JJF). U.S. District Court, District of Delaware. In July 2009, ARRIS filed a motion for contempt against SeaChange International seeking sanctions and the enforcement of the permanent injunction previously entered by the Court with respect to certain infringing SeaChange Video-on-Demand products. The original finding of infringement was affirmed by the Federal Circuit in 2006, and the asserted patent claims (with one exception) were affirmed as patentable by the U.S. Patent Office in a re-examination process initiated by SeaChange. In response to ARRIS motion, in August 2009, SeaChange filed suit

seeking a declaratory judgment that its products are non-infringing with respect to the patent. To date, ARRIS has introduced evidence of infringement and sanctions based on SeaChange s sales of accused products since 2002, and ARRIS has requested that enhanced sanctions be awarded if the Court determines that the

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infringement is willful. (In 2002, the Court held that the infringement in the original jury trial was willful and doubled the jury s damages award). The declaratory judgment action has been stayed and a hearing on the appropriateness of a contempt proceeding was held in March 2011. The parties have completed discovery as well as pre-hearing and post-hearing briefing and are awaiting action by the Court.

Multiservice Solutions v. MSOs Civil Action No. 6:11-cv-00114, Eastern District of Texas. In March 2011, Multiservice Solutions filed suit against 4 service operators alleging infringement of one US patent by all parties to the suit, no. 5,774,527, and another US patent by one party to the suit, no. 5,774,527. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past and future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome.

Olympic Developments AG v. MSOs Civil Action No. 2:11-cv-00612, Central District of California. In January 2011, Olympic Developments AG filed suit against 9 cable and satellite service operators alleging infringement of two US patents, nos. 5,475,585 and 6,246,400. Certain of our customers have requested that we provide indemnification. The Court is currently awaiting an answer to be filed by Comcast, and will thereafter set a scheduling conference. The complaint requests unspecified damages for past infringement and an injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome.

From time to time third parties demand that we or our customers enter into a license agreement with respect to patents owned, or allegedly owned, by the third parties. Such demands cause us to dedicate time to study the patents and enter into discussions with the third parties regarding the merits and value, if any, of the patents. These discussions, may materialize into license agreements or patent claims asserted against us or our customers. If asserted against our customers, our customers may request indemnification from us. It is not possible to determine the impact of any such demands and the related discussions on ARRIS business, results of operations or financial condition.

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Item 1A. Risk Factors

Our business is dependent on customers capital spending on broadband communication systems, and reductions by customers in capital spending adversely affect our business.

Our performance is dependent on customers capital spending for constructing, rebuilding, maintaining or upgrading broadband communications systems. Capital spending in the telecommunications industry is cyclical and can be curtailed or deferred on short notice. A variety of factors affect the amount of capital spending, and, therefore, our sales and profits, including:

- general economic conditions;
- customer specific financial or stock market conditions;
- availability and cost of capital;
- governmental regulation;
- demands for network services;
- competition from other providers of broadband and high speed services;
- acceptance of new services offered by our customers; and
- real or perceived trends or uncertainties in these factors.

Several of our customers have accumulated significant levels of debt. These high debt levels, coupled with the current turbulence and uncertainty in the capital markets, may impact their access to capital in the future. Even if the financial health of our customers remains intact, these customers may not purchase new equipment at levels we have seen in the past or expect in the future. During the later part of 2008 and most of 2009, the economy and financial markets were heavily impacted by housing market disruptions and foreclosures as well as the material disruptions in the credit markets. We cannot predict the impact if any of the recent financial market turmoil, or of specific customer financial challenges on our customer s expansion and maintenance expenditures.

The markets in which we operate are intensely competitive, and competitive pressures may adversely affect our results of operations.

The markets for broadband communication systems are extremely competitive and dynamic, requiring the companies that compete in these markets to react quickly and capitalize on change. This requires us to retain skilled and experienced personnel as well as to deploy substantial resources toward meeting the ever-changing demands of the industry. We compete with national and international manufacturers, distributors and wholesalers including many companies that are larger than we are. Our major competitors include:

- Aurora Networks;
- BigBand Networks;
- Casa Systems, Inc.:
- Cisco Systems, Inc.;
- Commscope, Inc.;
- Concurrent Computer Corporation;
- Ericsson (TandbergTV);

Harmonic, Inc.;

Motorola, Inc.;

SeaChange, Inc.;

SMC Networks;

Technicolor, Inc.;

TVC Communications, Inc.:

Ubee Interactive, Inc

In some instances, notably our software products, our customers themselves may be our competition as they may develop their own software. The rapid technological changes occurring in the broadband markets may lead to the entry of new competitors, including those with substantially greater resources than our own. Because the markets in which we compete are characterized by rapid growth and, in some cases, low barriers to entry, smaller niche market companies and start-up ventures also may become principal competitors in the future. Actions by existing competitors and the entry of new competitors may have an adverse effect on our sales and profitability. The broadband communications industry is further characterized by rapid technological change. In the future,

technological advances could lead to the obsolescence of some of our current products, which could have a material adverse effect on our business.

Further, many of our larger competitors are in a better position to withstand any significant, sustained reduction in capital spending by customers. They often have broader product lines and market focus and therefore are not as susceptible to downturns in a particular market. In addition, several of our competitors have been in operation longer than we have been, and therefore they have more established relationships with domestic and foreign broadband service users. We may not be able to compete successfully in the future, and competition may negatively impact our business.

Consolidations in the telecommunications industry could result in delays or reductions in purchases of products, which would have a material adverse effect on our business.

The telecommunications industry has experienced the consolidation of many industry participants. When consolidations occur, it is possible that the acquirer will not continue using the same suppliers, thereby possibly resulting in an immediate or future elimination of sales opportunities for us or our competitors, depending upon who had the business initially. Consolidations also could result in delays in purchasing decisions by the merged businesses. The purchasing decisions of the merged companies could have a material adverse effect on our business.

Mergers among the supplier base also have increased. Larger combined companies with pooled capital resources may be able to provide solution alternatives with which we would be put at a disadvantage to compete. The larger breadth of product offerings by these consolidated suppliers could result in customers electing to trim their supplier base for the advantages of one-stop shopping solutions for all of their product needs. Consolidation of the supplier base could have a material adverse effect on our business.

Our business is highly concentrated in the cable television portion of the telecommunications industry which is significantly impacted by technological change.

The cable television industry has gone through dramatic technological change resulting in MSOs rapidly migrating their business from a one-way television service to a two-way communications network enabling multiple services, such as high speed Internet access, residential telephony services, business telephony services and Internet access, video on demand and advertising services. New services that are, or may be offered by MSOs and other service providers, such as home security, power monitoring and control, high definition television, 3-D television, and a host of other new home services also are based on and will be characterized by rapidly evolving technology. The development of increasing transmission speed, density and bandwidth for Internet traffic has also enabled the provision of high quality, feature length video over the Internet. This so called over-the-top IP video service enables content providers such as Netflix, Hulu, CBS and portals like Google to provide video services on-demand, by-passing traditional video service providers. As these service providers enhance their quality and scalability, MSOs are moving to match them and provide even more competitive services over their existing networks, as well as over-the-top for delivery not only to televisions but to the computers, tablets, and telephones in order to remain competitive. Our business is dependent on our ability to develop the products that enable current and new customers to exploit these rapid technological changes. We believe the growth of over-the-top video represents a shift in the traditional video delivery paradigm and we cannot predict the effect it will have on our business.

In addition, the cable industry has and will continue to demand a move toward open standards. The move toward open standards is expected to increase the number of MSOs that will offer new services. This trend is expected to increase the number of competitors and drive down the capital costs per subscriber deployed. These factors may adversely impact both our future revenues and margins.

Our business comes primarily from a few key customers. The loss of one of these customers or a significant reduction in sales to one of these customers would have a material adverse effect on our business.

Our two largest customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. For the three months ended March 31, 2011, sales to Comcast accounted for approximately 27.3% and sales to Time Warner Cable accounted for approximately 16.0% of our total revenue. The loss of either of these customers, or one of our other large customers, or a significant reduction in the products or services provided to any of them would have a material adverse impact on our business. For each of these customers, we also are one of their largest suppliers. As a result, if from time-to-time customers elect to purchase products from our competitors in

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order to diversify their supplier base and to dual-source key products or to curtail purchasing due to budgetary or market conditions, such decisions could have material consequences to our business. In addition, because of the magnitude of our sales to these customers the terms and timing of our sales are heavily negotiated, and even minor changes can have a significant impact upon our business.

We may pursue acquisitions and investments that could adversely affect our business.

In the past, we have made acquisitions of and investments in businesses, products, and technologies to complement or expand our business. While we have no announced plans for additional acquisitions, future acquisitions are part of our strategic objectives and may occur. If we identify an acquisition candidate, we may not be able to successfully negotiate or finance the acquisition or integrate the acquired businesses, products, or technologies with our existing business and products. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, amortization expenses, and substantial goodwill. We will test the goodwill that is created by acquisitions, at least annually and will record an impairment charge if its value has declined. For instance, in the fourth quarter of 2008, we recorded a substantial impairment charge with respect to the goodwill that was created as part of our acquisition of C-COR.

We have substantial goodwill.

Our financial statements reflect substantial goodwill, approximately $233.5 million as of March 31, 2011, that was recognized in connection with the acquisitions that we have made. We annually (and more frequently if changes in circumstances indicate that the asset may be impaired) review the carrying amount of our goodwill in order to determine whether it has been impaired for accounting purposes. In general, if the fair value of the corresponding reporting unit s goodwill is less that the carrying value of the goodwill, we record an impairment charge. The determination of fair value is dependent upon a number of factors, including assumptions about future cash flows and growth rates that are based on our current and long-term business plans. No goodwill impairment was recorded in 2009, 2010, or the first quarter of 2011. We recorded a non-cash goodwill impairment charge of $128.9 million and $80.4 million related to the ATS and MCS reporting units, respectively, during the fourth quarter of 2008. As the ongoing expected cash flows and carrying amounts of our remaining goodwill are assessed, changes in the economic conditions, changes to our business strategy, changes in operating performance or other indicators of impairment could cause us to realize additional impairment charges in the future. For additional information, see the discussion under Critical Accounting Policies in Item 7 in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the United States Securities and Exchange Commission (SEC).

We may have difficulty in forecasting our sales.

Because a significant portion of the purchases by our customers are discretionary, accurately forecasting sales is difficult. In addition, in recent years our customers have submitted their purchase orders less evenly over the course of each quarter and year and with shorter lead times than they have historically. This has made it even more difficult for us to forecast sales and other financial measures, which can result in us maintaining inventory levels that are too high or too low for our ultimate needs.

Our business has and is expected to have higher levels of software sales which may result in greater volatility in our operating results.

The level of our Media & Communications Systems sales fluctuates significantly quarter to quarter which results in greater volatility of our operating results than has been typical in the past, when the main source of volatility was the high proportion of quick-turn product sales. The timing of revenue recognition on software and system sales is based on specific contract terms and, in certain cases, is dependent upon completion of certain activities and customer acceptance which are difficult to forecast accurately.

The level of software sales in our BCS segment is expected to increase. In the second quarter of 2011, we expect to begin to deliver software upgrades for our CMTS line cards.

Because the gross margins associated with software and systems sales are substantially higher than our average gross margins, fluctuations in quarterly software sales have a disproportionate effect on operating results and earnings per share and could result in our operating results falling short of the expectations of the investment community.

Products currently under development may fail to realize anticipated benefits.

Rapidly changing technologies, evolving industry standards, frequent new product introductions and relatively short product life cycles characterize the markets for our products. The technology applications that we currently are developing may not ultimately be successful. Even if the products in development are successfully brought to market, they may not be widely used or we may not be able to successfully capitalize on their technology. To compete successfully, we must quickly design, develop, manufacture and sell new or enhanced products that provide increasingly higher levels of performance and reliability. However, we may not be able to successfully develop or introduce these products if they:

- are not cost-effective;
- are not brought to market in a timely manner;
- fail to achieve market acceptance; or
- fail to meet industry certification standards.

Furthermore, our competitors may develop similar or alternative technologies that, if successful, could have a material adverse effect on us. Our strategic alliances are based on business relationships that have not been the subject of written agreements expressly providing for the alliance to continue for a significant period of time. The loss of a strategic relationship could have a material adverse effect on the progress of new products under development with that third party.

Our success depends in large part on our ability to attract and retain qualified personnel in all facets of our operations.

Competition for qualified personnel is intense, and we may not be successful in attracting and retaining key personnel, which could impact our ability to maintain and grow our operations. Our future success will depend, to a significant extent, on the ability of our management to operate effectively. In the past, competitors and others have attempted to recruit our employees and in the future, their attempts may continue. The loss of services of any key personnel, the inability to attract and retain qualified personnel in the future or delays in hiring required personnel, particularly engineers and other technical professionals, could negatively affect our business.

We are substantially dependent on contract manufacturers, and an inability to obtain adequate and timely delivery of supplies could adversely affect our business.

Many components, subassemblies and modules necessary for the manufacture or integration of our products are obtained from a sole supplier or a limited group of suppliers. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our reliance on subcontractors involves several risks including a potential inability to obtain an adequate supply of required components, subassemblies or modules and reduced control over pricing, quality and timely delivery of components, subassemblies or modules. Historically, we have not maintained long-term agreements with any of our suppliers or subcontractors. An inability to obtain adequate deliveries or any other circumstance that would require us to seek alternative sources of supply could affect our ability to ship products on a timely basis. Any inability to reliably ship our products on time could damage relationships with current and prospective customers and harm our business.

Our international operations may be adversely affected by any decline in the demand for broadband systems designs and equipment in international markets.

Sales of broadband communications equipment into international markets are an important part of our business. Our products are marketed and made available to existing and new potential international customers. In addition, United States broadband system designs and equipment are increasingly being employed in international markets, where market penetration is relatively lower than in the United States. While international operations are expected to comprise an integral part of our future business, international markets may no longer continue to develop at the current rate, or at all. We may fail to receive additional contracts to supply equipment in these markets.

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Our international operations may be adversely affected by changes in the foreign laws in the countries in which we and our manufacturers and assemblers have plants.

A significant portion of our products are manufactured or assembled in China, Ireland, Mexico, and other countries outside of the United States. The governments of the foreign countries in which our products are manufactured may pass laws that impair our operations, such as laws that impose exorbitant tax obligations or nationalize these manufacturing facilities.

In addition, we own a manufacturing facility located in Tijuana, Mexico. This operation is exposed to certain risks as a result of its location, including:

- changes in international trade laws, such as the North American Free Trade Agreement and Prosec, affecting our import and export activities;
- changes in, or expiration of, the Mexican government s IMMEX (Manufacturing Industry Maquiladora and Export Services) program, which provides economic benefits to us;
- changes in labor laws and regulations affecting our ability to hire and retain employees;
- fluctuations of foreign currency and exchange controls;
- potential political instability and changes in the Mexican government;
- potential regulatory changes; and
- general economic conditions in Mexico.

Any of these risks could interfere with the operation of this facility and result in reduced production, increased costs, or both. In the event that production capacity of this facility is reduced, we could fail to ship products on schedule and could face a reduction in future orders from dissatisfied customers. If our costs to operate this facility increase, our margins would decrease. Reduced shipments and margins would have an adverse effect on our financial results.

We face risks relating to currency fluctuations and currency exchange.

On an ongoing basis we are exposed to various changes in foreign currency rates because significant sales are denominated in foreign currencies. These risk factors can impact our results of operations, cash flows and financial position. We manage these risks through regular operating and financing activities and periodically use derivative financial instruments such as foreign exchange forward and option contracts. There can be no assurance that our risk management strategies will be effective.

We also may encounter difficulties in converting our earnings from international operations to U.S. dollars for use in the United States. These obstacles may include problems moving funds out of the countries in which the funds were earned and difficulties in collecting accounts receivable in foreign countries where the usual accounts receivable payment cycle is longer.

We depend on channel partners to sell our products in certain regions and are subject to risks associated with these arrangements.

We utilize distributors, value-added resellers, system integrators, and manufacturers representatives to sell our products to certain customers and in certain geographic regions to improve our access to these customers and regions and to lower our overall cost of sales and post-sales support. Our sales through channel partners are subject to a number of risks, including:

- ability of our selected channel partners to effectively sell our products to end customers;
- our ability to continue channel partner arrangements into the future since most are for a limited term and subject to mutual agreement to extend;
- a reduction in gross margins realized on sale of our products; and

a diminution of contact with end customers which, over time, could adversely impact our ability to develop new products that meet customers evolving requirements.

Our stock price has been and may continue to be volatile.

Our common stock is currently traded on The NASDAQ Global Select Market. The trading price of our common stock has been and may continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors including:

future announcements concerning us, key customers or competitors;

- quarterly variations in operating results;
- changes in financial estimates and recommendations by securities analysts;
- developments with respect to technology or litigation;
- the operating and stock price performance of our competitors; and
- acquisitions and financings

Fluctuations in the stock market, generally, also impact the volatility of our stock price. General stock market movements may adversely affect the price of our common stock, regardless of our operating performance.

We may face higher costs associated with protecting our intellectual property or obtaining access necessary to intellectual property of others.

Our future success depends in part upon our proprietary technology, product development, technological expertise and distribution channels. We cannot predict whether we can protect our technology or whether competitors can develop similar technology independently. We have received, directly or indirectly, and may continue to receive from third parties, including some of our competitors, notices claiming that we, or our customers using our products, have infringed upon third-party patents or other proprietary rights. We are a defendant in proceedings (and other proceedings have been threatened) in which our customers were sued for patent infringement and sued, or made claims against, us and other suppliers for indemnification, and we may become involved in similar litigation involving these and other customers in the future. These claims, regardless of their merit, result in costly litigation, divert the time, attention and resources of our management, delay our product shipments, and, in some cases, require us to enter into royalty or licensing agreements. If a claim of product infringement against us is successful and we fail to obtain a license or develop non-infringing technology, our business and operating results could be materially and adversely affected. In addition, the payment of any damages or any necessary licensing fees or indemnification costs associated with a patent infringement claim could be material and could also materially adversely affect our operating results. See Part II, Item 1, Legal Proceedings .

We do not intend to pay cash dividends in the foreseeable future.

Although from time to time we may consider repurchasing shares of our common stock, we do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, the payment of dividends in certain circumstances may be prohibited by the terms of our current and future indebtedness.

We have anti-takeover defenses that could delay or prevent an acquisition of our company.

We have a shareholder rights plan (commonly known as a poison pill). This plan is not intended to prevent a takeover, but is intended to protect and maximize the value of stockholders interests. However, the plan could make it more difficult for a third party to acquire us or may delay that process.

We have the ability to issue preferred shares without stockholder approval.

Our common shares may be subordinate to classes of preferred shares issued in the future in the payment of dividends and other distributions made with respect to common shares, including distributions upon liquidation or dissolution. Our Certificate of Incorporation permits our board of directors to issue preferred shares without first obtaining stockholder approval. If we issued preferred shares, these additional securities may have dividend or liquidation preferences senior to the common shares. If we issue convertible preferred shares, a subsequent conversion may dilute the current common stockholders interest.

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Item 6. EXHIBITS

Exhibit No.	*Description of Exhibit*
31.1	Section 302 Certification of Chief Executive Officer, filed herewith
31.2	Section 302 Certification of Chief Financial Officer, filed herewith
32.1	Section 906 Certification of Chief Executive Officer, filed herewith
32.2	Section 906 Certification of Chief Financial Officer, filed herewith
101.INS	XBRL Instant Document, filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document, filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document, filed herewith
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document, filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document, filed herewith

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SIGNATURES

Pursuant to the requirements the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARRIS GROUP, INC.

/s/ David B. Potts
David B. Potts
Executive Vice President, Chief Financial Officer,
Chief Accounting Officer, and Chief Information
Officer

Dated: May 6, 2011