

ARRIS GROUP INC  
Form 10-Q  
November 05, 2010

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

**FORM 10-Q  
For the quarter ended September 30, 2010  
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 October 31, 2010, 123,542,761 shares of the registrant's Common Stock, \$0.01 par value, were outstanding.

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**ARRIS GROUP, INC.**  
**FORM 10-Q**  
**For the Three and Nine Months Ended September 30, 2010**  
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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)****ARRIS GROUP, INC.****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share data) (unaudited)**

|  | <b>September<br/>30,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|--|-----------------------------------|----------------------------------|
| <b>ASSETS</b>  |                                   |                                  |
| Current assets:  |                                   |                                  |
| Cash and cash equivalents  | \$ 351,894                        | \$ 500,565                       |
| Short-term investments, at fair value  | 288,463                           | 125,031                          |
| Total cash, cash equivalents and short-term investments  | 640,357                           | 625,596                          |
| Restricted cash  | 4,480                             | 4,475                            |
| Accounts receivable (net of allowances for doubtful accounts of \$2,338 in 2010 and \$2,168 in 2009)       | 133,915                           | 143,708                          |
| Other receivables  | 2,654                             | 6,113                            |
| Inventories (net of reserves of \$16,541 in 2010 and \$22,151 in 2009)                                     | 89,203                            | 95,851                           |
| Prepays  | 8,934                             | 11,675                           |
| Current deferred income tax assets   | 28,585                            | 35,994                           |
| Income taxes recoverable   | 17,094                            | 3,106                            |
| Other current assets   | 11,253                            | 15,790                           |
| Total current assets   | 936,475                           | 942,308                          |
| Property, plant and equipment (net of accumulated depreciation of \$122,679 in 2010 and \$106,744 in 2009) | 56,816                            | 57,195                           |
| Goodwill   | 235,109                           | 235,388                          |
| Intangible assets (net of accumulated amortization of \$217,735 in 2010 and \$190,722 in 2009)             | 177,560                           | 204,572                          |
| Investments  | 29,591                            | 20,618                           |
| Noncurrent deferred income tax assets  | 6,560                             | 6,759                            |
| Other assets   | 6,129                             | 8,776                            |
|  | \$ 1,448,240                      | \$ 1,475,616                     |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                                   |                                  |
| Current liabilities:   |                                   |                                  |
| Accounts payable   | \$ 52,011                         | \$ 53,979                        |
| Accrued compensation, benefits and related taxes   | 25,913                            | 36,936                           |
| Accrued warranty   | 3,504                             | 4,265                            |
| Deferred revenue   | 36,029                            | 47,044                           |
| Current portion of long-term debt  | 12                                | 124                              |
| Other accrued liabilities  | 25,891                            | 46,203                           |
| Total current liabilities  | 143,360                           | 188,551                          |
|  | 204,053                           | 211,248                          |

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|   |               |              |
|---|---------------|--------------|
| Long-term debt, net of current portion (net of discount of \$37,997 in 2010 and \$49,802 in 2009)   |               |              |
| Accrued pension   | 17,383        | 16,408       |
| Noncurrent income taxes payable   | 16,509        | 14,815       |
| Noncurrent deferred income tax liabilities  | 32,193        | 37,204       |
| Other long-term liabilities   | 14,926        | 16,021       |
| <br>Total liabilities   | <br>428,424   | <br>484,247  |
| <br>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; 123.5 million and 125.6 million shares issued and outstanding in 2010 and 2009, respectively | 1,406         | 1,388        |
| Capital in excess of par value  | 1,199,184     | 1,183,872    |
| Treasury stock at cost, 16.8 million shares in 2010 and 13.0 million shares in 2009   | (115,248)     | (75,960)     |
| Accumulated deficit   | (58,927)      | (111,734)    |
| Unrealized gain (loss) on marketable securities   | (374)         | 28           |
| Unfunded pension liability, including income tax impact of \$1,169 in 2010 and 2009   | (6,041)       | (6,041)      |
| Cumulative translation adjustments  | (184)         | (184)        |
| <br>Total stockholders' equity  | <br>1,019,816 | <br>991,369  |
|   | \$ 1,448,240  | \$ 1,475,616 |

See accompanying notes to the 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<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2010                                | 2009       | 2010                               | 2009       |
| Net sales:  |                                     |            |                                    |            |
| Products  | \$ 242,167                          | \$ 247,430 | \$ 730,487                         | \$ 730,002 |
| Services  | 32,119                              | 28,342     | 90,851                             | 77,809     |
| Total net sales                                       | 274,286                             | 275,772    | 821,338                            | 807,811    |
| Cost of sales:  |                                     |            |                                    |            |
| Products  | 157,510                             | 146,910    | 449,203                            | 441,202    |
| Services  | 14,789                              | 13,389     | 44,359                             | 38,346     |
| Total cost of sales                                   | 172,299                             | 160,299    | 493,562                            | 479,548    |
| Gross margin  | 101,987                             | 115,473    | 327,776                            | 328,263    |
| Operating expenses:                                   |                                     |            |                                    |            |
| Selling, general and administrative expenses          | 33,913                              | 36,311     | 103,489                            | 110,782    |
| Research and development expenses                     | 35,138                              | 30,909     | 105,041                            | 89,447     |
| Restructuring charges                                 |                                     | 73         | 73                                 | 785        |
| Amortization of intangible assets                     | 8,970                               | 9,281      | 27,013                             | 27,807     |
| Total operating expenses                              | 78,021                              | 76,574     | 235,616                            | 228,821    |
| Operating income                                      | 23,966                              | 38,899     | 92,160                             | 99,442     |
| Other expense (income):                               |                                     |            |                                    |            |
| Interest expense                                      | 4,533                               | 4,356      | 13,728                             | 13,121     |
| Gain on investments                                   | (369)                               | (238)      | (401)                              | (453)      |
| Interest income                                       | (399)                               | (424)      | (1,468)                            | (1,172)    |
| Loss on foreign currency                              | 94                                  | 1,114      | 283                                | 3,642      |
| Gain on debt retirement                               | (263)                               |            | (378)                              | (4,152)    |
| Other expense (income), net                           | 280                                 | (263)      | 107                                | (887)      |
| Income from continuing operations before income taxes | 20,090                              | 34,354     | 80,289                             | 89,343     |
| Income tax expense                                    | 6,048                               | 12,655     | 27,482                             | 31,853     |
| Net income  | \$ 14,042                           | \$ 21,699  | \$ 52,807                          | \$ 57,490  |
| Net income per common share:                          |                                     |            |                                    |            |
| Basic   | \$ 0.11                             | \$ 0.17    | \$ 0.42                            | \$ 0.46    |
| Diluted   | \$ 0.11                             | \$ 0.17    | \$ 0.41                            | \$ 0.45    |

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Weighted average common shares:

|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | 125,237 | 125,326 | 125,927 | 124,381 |
| Diluted | 127,638 | 129,695 | 129,103 | 127,916 |

See accompanying notes to the consolidated financial statements.

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**ARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands) (unaudited)

|  | <b>Nine Months Ended September</b> |             |
|--|------------------------------------|-------------|
|  | <b>30,</b>                         |             |
|  | <b>2010</b>                        | <b>2009</b> |
| Operating activities:  |                                    |             |
| Net income   | \$ 52,807                          | \$ 57,490   |
| Adjustments to reconcile net income to net cash provided by operating activities:            |                                    |             |
| Depreciation   | 16,893                             | 15,370      |
| Amortization of intangible assets  | 27,013                             | 27,807      |
| Stock compensation expense   | 16,058                             | 11,714      |
| Deferred income tax provision  | 2,598                              | 13,678      |
| Amortization of deferred finance fees  | 527                                | 548         |
| Provision for doubtful accounts  | 83                                 | 1           |
| Gain on investments  | (401)                              | (453)       |
| Loss (gain) on disposal of fixed assets  | 369                                | (46)        |
| Excess income tax benefits from stock-based compensation plans                               | (2,683)                            | (2,027)     |
| Non-cash interest expense  | 8,548                              | 8,308       |
| Gain on debt retirement  | (378)                              | (4,152)     |
| Changes in operating assets and liabilities, net of effect of acquisitions and dispositions: |                                    |             |
| Accounts receivable  | 9,710                              | 40,801      |
| Other receivables  | 2,760                              | 539         |
| Inventories  | 6,648                              | 30,449      |
| Income taxes recoverable   | (14,173)                           | (2,868)     |
| Accounts payable and accrued liabilities   | (42,226)                           | (32,620)    |
| Prepays and other, net   | 11,788                             | 6,665       |
| Net cash provided by operating activities  | 95,941                             | 171,204     |
| Investing activities:  |                                    |             |
| Purchases of property, plant and equipment   | (17,127)                           | (14,327)    |
| Cash paid for acquisition, net of cash acquired  |                                    | (8,130)     |
| Cash proceeds from sale of property, plant and equipment                                     | 243                                | 208         |
| Purchases of investments   | (331,547)                          | (151,845)   |
| Sales of investments   | 159,914                            | 54,416      |
| Net cash used in investing activities  | (188,517)                          | (119,678)   |
| Financing activities:  |                                    |             |
| Payment of debt obligations  | (112)                              | (121)       |
| Early redemption of long-term debt   | (18,331)                           | (10,556)    |
| Repurchase of common stock   | (39,288)                           |             |
| Excess income tax benefits from stock-based compensation plans                               | 2,683                              | 2,027       |
| Repurchase of shares to satisfy employee tax withholdings                                    | (6,422)                            | (2,180)     |
| Proceeds from issuance of common stock, net  | 5,375                              | 11,205      |



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|  |            |            |
|--|------------|------------|
| Net cash provided by (used in) financing activities  | (56,095)   | 375        |
| Net increase (decrease) in cash and cash equivalents | (148,671)  | 51,901     |
| Cash and cash equivalents at beginning of period     | 500,565    | 409,894    |
| Cash and cash equivalents at end of period           | \$ 351,894 | \$ 461,795 |

See accompanying notes to the 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 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, 2009, as filed with the United States Securities and Exchange Commission (SEC).

**Note 2. Impact of Recently Adopted Accounting Standards**

In October 2009, the FASB amended the accounting standards for revenue recognition to remove tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of industry-specific software revenue recognition guidance. In October 2009, the FASB also amended the accounting standards for multiple deliverable revenue arrangements to:

- (i) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- (ii) require an entity to allocate revenue in an arrangement using best estimated selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and
- (iii) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

The Company elected to early adopt this accounting guidance at the beginning of its first quarter of fiscal year 2010 on a prospective basis for arrangements originating or materially modified after January 1, 2010. The adoption of the new revenue recognition accounting policy resulted in an increase in revenue of approximately \$1 million and \$2 million for the three and nine months ended September 30, 2010, respectively.

**Note 3. Change in Significant Accounting Policies**

ARRIS's significant accounting policies are disclosed in the Company's Form 10-K for the year ended December 31, 2009, as filed with the SEC. The following discussion addresses a change in the Company's revenue recognition accounting policy.

*Revenue Recognition*

ARRIS generates revenue as a result of varying activities, including the delivery of stand-alone equipment, custom design and installation services, and bundled sales arrangements inclusive of equipment, software and services. The revenue from these activities is recognized in accordance with applicable accounting guidance and their related interpretations.

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Revenue is recognized when all of the following criteria have been met:

*When persuasive evidence of an arrangement exists.* Contracts and customer purchase orders are used to determine the existence of an arrangement.

*Delivery has occurred.* Shipping documents, proof of delivery and customer acceptance (when applicable) are used to verify delivery.

*The fee is fixed or determinable.* Pricing is considered fixed and determinable at the execution of a customer arrangement, based on specific products and quantities to be delivered at specific prices. This determination includes a review of the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment or future discounts.

*Collectability is reasonably assured.* The Company assesses the ability to collect from customers based on a number of factors that include information supplied by credit agencies, analyzing customer accounts, reviewing payment history and consulting bank references. Should a circumstance arise where a customer is deemed not creditworthy, all revenue related to the transaction will be deferred until such time that payment is received and all other criteria to allow the Company to recognize revenue have been met.

Revenue is deferred if any of the above revenue recognition criteria is not met as well as when certain circumstances exist for any of our products or services, including, but not limited to:

When undelivered products or services that are essential to the functionality of the delivered product exist, revenue is deferred until such undelivered products or services are delivered as the customer would not have full use of the delivered elements.

When required acceptance has not occurred.

When trade-in rights are granted at the time of sale, that portion of the sale is deferred until the trade-in right is exercised or the right expires. In determining the deferral amount, management estimates the expected trade-in rate and future value of the product upon trade-in. These factors are periodically reviewed and updated by management, and the updates may result in either an increase or decrease in the deferral.

*Equipment* The Company provides cable system operators with equipment that can be placed within various stages of a broadband cable system that allows for the delivery of cable telephony, video and high speed data as well as outside plant construction and maintenance equipment. For equipment sales, revenue recognition is generally established when the products have been shipped, risk of loss has transferred, objective evidence exists that the product has been accepted, and no significant obligations remain relative to the transaction. Additionally, based on historical experience, ARRIS has established reliable estimates related to sales returns and other allowances for discounts. These estimates are recorded as a reduction to revenue at the time the revenue is initially recorded.

*Software Sold Without Tangible Equipment* ARRIS sells internally developed software as well as software developed by outside third parties that does not require significant production, modification or customization. For arrangements that contain only software and the related post-contract support, the Company recognizes revenue in accordance with the applicable software revenue recognition guidance. If the arrangement includes multiple elements that are software only, then the software revenue recognition guidance is applied and the fee is allocated to the various elements based on vendor-specific objective evidence ( VSOE ) of fair value. If sufficient VSOE of fair value does not exist for the allocation of revenue to all the various elements in a multiple element software arrangement, all revenue from the arrangement is deferred until the earlier of the point at which such sufficient VSOE of fair value is established or all elements within the arrangement are delivered. If VSOE of fair value exists for all undelivered elements, but does not exist for one or more delivered elements, the arrangement consideration is allocated to the various elements of the arrangement using the residual method of accounting. Under the residual method, the amount of the arrangement consideration allocated to the delivered elements is equal to the total arrangement consideration less the aggregate fair value of the undelivered elements. Under the residual method, if VSOE exists for the

undelivered element, generally post contract support ( PCS ), the fair  
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value of the undelivered element is deferred and recognized ratably over the term of the PCS contract, and the remaining portion of the arrangement is recognized as revenue upon delivery. If sufficient VSOE of fair value does not exist for PCS, revenue is recognized ratably over the term of support.

*Standalone Services* Installation, training, and professional services are generally recognized in service revenues when performed.

*Incentives* Customer incentive programs that include consideration, primarily rebates/credits to be used against future product purchases and certain volume discounts, have been recorded as a reduction of revenue when the shipment of the requisite equipment occurs.

*Value Added Resellers* ARRIS employs the sell-in method of accounting for revenue when using a Value Added Reseller ( VAR ) as our channel to market. Because product returns are restricted, revenue under this method is recognized at the time of shipment to the VAR provided all criteria for recognition are met.

*Multiple Element Arrangements* Certain customer transactions may include multiple deliverables based on the bundling of equipment, software and services. When a multiple element arrangement exists, the fee from the arrangement is allocated to the various deliverables, to the extent appropriate, so that the proper amount can be recognized as revenue as each element is delivered. Based on the composition of the arrangement, the Company analyzes the provisions of the accounting guidance to determine the appropriate model that is applied towards accounting for the multiple element arrangement. If the arrangement includes a combination of elements that fall within different applicable guidance, ARRIS follows the provisions of the hierarchical literature to separate those elements from each other and apply the relevant guidance to each.

For multiple element arrangements that include software or have a software-related element that is essential to the functionality of the tangible product, more than incidental but that does not involve significant production, modification or customization, the Company applies, and will continue to apply the provisions of the relevant software revenue recognition accounting guidance for arrangements originating before January 1, 2010 that continue to be effective after January 1, 2010.

For multiple element arrangements that include software or have a software-related element that is more than incidental and does involve significant production, modification or customization, revenue is recognized using the contract accounting guidelines by applying the percentage of completion or completed contract method. The Company recognizes software license and associated professional services revenue for its mobile workforce management software license product installations using the percentage of completion method of accounting as the Company believes that its estimates of costs to complete and extent of progress toward completion of such contracts are reliable. For certain software license arrangements where professional services are being provided and are deemed to be essential to the functionality or are for significant production, modification, or customization of the software product, both the software and the associated professional service revenue are recognized using the completed contract method if the Company does not have the ability to reasonably estimate contract costs at the inception of the contracts. Under the completed contract method, revenue is recognized when the contract is complete, and all direct costs and related revenues are deferred until that time. The entire amount of an estimated loss on a contract is accrued at the time a loss on a contract is projected. Actual profits and losses may differ from these estimates.

If the arrangement includes multiple elements, the fee is allocated to the various elements based on VSOE of fair value. If sufficient VSOE of fair value does not exist for the allocation of revenue to all the various elements in a multiple element arrangement, all revenue from the arrangement is deferred until the earlier of the point at which such sufficient VSOE is established or all elements within the arrangement are delivered. If VSOE of fair value exists for all undelivered elements, but does not exist for one or more delivered elements, the arrangement consideration is allocated to the various elements of the arrangement using the residual method of accounting. Under the residual method, the amount of the arrangement consideration allocated to the delivered elements is equal to the total arrangement consideration less the aggregate fair value of the undelivered elements. Using this method, any potential discount on the arrangement is allocated entirely to the delivered elements, which ensures that the amount of revenue recognized at any point in time is not overstated. Under the residual method, if VSOE exists for the undelivered element, generally PCS, the fair value of the undelivered element is deferred and recognized ratably over the term of the PCS contract, and the remaining portion of the arrangement is recognized as revenue upon delivery, which

generally occurs upon delivery of the product or implementation of the system. License revenue allocated to software products, in certain circumstances, is recognized upon delivery of the software products. Many of ARRIS products are sold in combination with customer support and maintenance services, which consist of software updates and product support. Software updates provide customers with rights to unspecified

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software updates that ARRIS chooses to develop and to maintenance releases and patches that the Company chooses to release during the period of the support period. Product support services include telephone support, remote diagnostics, email and web access, access to on-site technical support personnel and repair or replacement of hardware in the event of damage or failure during the term of the support period. Maintenance and support service fees are recognized ratably under the straight-line method over the term of the contract, which is generally one year. The Company does not record receivables associated with maintenance revenues without a firm, non-cancelable order from the customer. VSOE of fair value is determined based on the price charged when the same element is sold separately and based on the prices at which our customers have renewed their customer support and maintenance. For elements that are not yet being sold separately, the price established by management, if it is probable that the price, once established, will not change before the separate introduction of the element into the marketplace is used to measure VSOE of fair value for that element.

The Company elected to early adopt accounting standards on a prospective basis related to multiple element arrangements as discussed in Note 2 of the Notes to the Consolidated Financial Statements. The Company applies the previous applicable accounting guidance for arrangements originating prior to the adoption date of January 1, 2010. Below is a comparison of: 1) units of accounting, 2) allocation of arrangement consideration and 3) timing of revenue recognition applying the old and new guidance.

***Units of Accounting:***

**Before January 1, 2010:** For multiple element arrangements originating before January 1, 2010, the deliverables are separated into more than one unit of accounts when the following criteria are met: (i) the delivered element(s) have value to the customer on a stand-alone basis, (ii) objective and reliable evidence of fair value exists for the undelivered element(s), and (iii) delivery of the undelivered element(s) is probable and substantially in the control of the Company.

**After December 31, 2009:** For multiple element arrangements (other than software sold without tangible equipment) originating or materially modified after December 31, 2009, the deliverables are separated into more than one unit of accounting when the following criteria are met: (i) the delivered element(s) have value to the customer on a stand-alone basis, and (ii) if a general right of return exists relative to the delivered item, delivery or performance of the undelivered element(s) is probable and substantially in the control of the Company.

***Allocation of Arrangement Consideration:***

**Before January 1, 2010:** Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or by using the residual method if objective evidence of fair value does not exist for the delivered element(s).

**After December 31, 2009:** The Company uses best estimated selling price ( *BESP* ) of the element(s) for the allocation of arrangement consideration when unable to establish VSOE or third-party evidence of selling price ( *TPE* ). The objective of *BESP* is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. *BESP* is generally used for new or highly customized offerings and solutions or elements not priced within a narrow range. The Company determines *BESP* for a product or service by considering multiple factors including, but not limited to, geographies, market conditions, competitive landscape, internal costs, gross margin objectives, and pricing practices. The Company uses the relative selling price basis for the allocation of the arrangement consideration.

The adoption of the new revenue recognition accounting policy resulted in an increase in revenue of approximately \$1 million and \$2 million for the three and nine months ended September 30, 2010, respectively.

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ARRIS investments as of September 30, 2010 and December 31, 2009 consisted of the following (in thousands):

|                               | As of September<br>30,<br>2010 | As of December<br>31,<br>2009 |
|-------------------------------|--------------------------------|-------------------------------|
| Current Assets:               |                                |                               |
| Trading securities            | \$                             | \$ 4,970                      |
| Available-for-sale securities | 288,463                        | 120,061                       |
|                               | 288,463                        | 125,031                       |
| Noncurrent Assets:            |                                |                               |
| Available-for-sale securities | 25,591                         | 16,618                        |
| Cost method investments       | 4,000                          | 4,000                         |
|                               | 29,591                         | 20,618                        |
| Total                         | \$ 318,054                     | \$ 145,649                    |

ARRIS investments in debt and marketable equity securities are categorized as trading or available-for-sale. The Company currently does not hold any held-to-maturity or trading 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 September 30, 2010 and December 31, 2009 were not material. The amortized cost basis of the Company's investments approximates fair value.

As of September 30, 2010 and December 31, 2009, 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 September 30, 2010, 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 5. 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.





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The following table presents the Company's investment assets and foreign currency contract positions measured at fair value on a recurring basis as of September 30, 2010 (in thousands):

|   | Level 1   | Level 2 | Level 3 |
|---|-----------|---------|---------|
| Current investments                             | \$ 94,737 | 193,726 |         |
| Non-current investments                         | 5,343     | 20,248  |         |
| Foreign currency contracts - asset position     | 153       |         |         |
| Foreign currency contracts - liability position | 1,298     |         |         |

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 4 and Note 6 for further information on the Company's investments and derivative instruments.

The table below includes a roll-forward of the Company's auction rate securities that was previously classified as a Level 3 in the fair value hierarchy (in thousands):

|                                      |                |
|--------------------------------------|----------------|
|                                      | <b>Level 3</b> |
| Estimated fair value January 1, 2010 | \$ 4,970       |
| Change in fair value                 | 30             |
| Disposals                            | (5,000)        |
| Fair value September 30, 2010        | \$             |

ARRIS had \$0 and \$5.0 million invested in an auction rate security at September 30, 2010 and December 31, 2009, respectively. During the quarter ended March 31, 2010, ARRIS sold at par \$2.1 million of the \$5.0 million auction rate security. ARRIS sold at par the remaining \$2.9 million of the auction rate security during the quarter ended June 30, 2010.

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 6. 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 15 months. Derivative instruments which are subject to master netting arrangements are not offset in the Consolidated Balance Sheets.



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The fair values of ARRIS derivative instruments recorded in the Consolidated Balance Sheet as of September 30, 2010 were as follows (in thousands):

| <b>Asset Derivatives</b>                           |                               | <b>Liability Derivatives</b> |            |
|--|-------------------------------|------------------------------|------------|
| Balance Sheet Location                             | Fair Value                    | Balance Sheet Location       | Fair Value |
| Derivatives Not Designated as Hedging Instruments: |                               |                              |            |
| Foreign exchange contracts                         | Other current assets<br>\$153 | Other accrued liabilities    | \$1,298    |

The change in the fair values of ARRIS derivative instruments recorded in the Consolidated Statements of Operations during the three and nine months ended September 30, 2010 and 2009 were as follows (in thousands):

| Statement of Operations Location                   | <b>Three Months Ended<br/>September 30,</b> |         | <b>Nine Months Ended<br/>September 30,</b> |         |
|--|---|---------|--|---------|
|  | 2010  | 2009    | 2010                                       | 2009    |
| Derivatives Not Designated as Hedging Instruments: |   |         |  |         |
| Foreign exchange contracts                         | Loss on foreign currency<br>\$2,015         | \$1,425 | \$23                                       | \$3,099 |

**Note 7. Pension Benefits**

*Components of Net Periodic Pension Cost (in thousands):*

|                                    | <b>Three Months Ended<br/>September 30,</b> |        | <b>Nine Months Ended<br/>September 30,</b> |          |
|------------------------------------|---|--------|--|----------|
|                                    | 2010  | 2009   | 2010                                       | 2009     |
| Service cost                       | \$ 68                                       | \$ 245 | \$ 205                                     | \$ 735   |
| Interest cost                      | 529   | 530    | 1,585                                      | 1,590    |
| Expected gain on plan assets       | (380)                                       | (281)  | (1,140)                                    | (844)    |
| Amortization of prior service cost | 65  | 115    | 195  | 346      |
| Amortization of net loss           | 70  | 119    | 210  | 358      |
| Net periodic pension cost          | \$ 352                                      | \$ 728 | \$ 1,055                                   | \$ 2,185 |

**Employer Contributions**

No minimum funding contributions are required in 2010 under the Company's defined benefit plan. However, the Company made voluntary contributions to the plan of approximately \$27 thousand and \$80 thousand for the three and nine months ended September 30, 2010, respectively. 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 September 30, 2010 was approximately \$13.1 million and is included in Investments on the Consolidated Balance Sheets.

**Note 8. 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

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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 nine months ended September 30, 2010 was as follows (in thousands):

|   |              |
|---|--------------|
| Balance at December 31, 2009                                    | \$ 7,679     |
| Accruals related to warranties (including changes in estimates) | 1,828        |
| Settlements made (in cash or in kind)                           | (3,160)      |
| <br>Balance at September 30, 2010                               | <br>\$ 6,347 |

**Note 9. 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, 2009      | \$ 1,890       |
| Payments                             | (280)          |
| Adjustments to accrual               |                |
| <br>Balance as of September 30, 2010 | <br>\$ 1,610   |

During the second quarter of 2009, ARRIS consolidated two facilities in Colorado. The consolidation allowed the Company to combine its sales force and create a unified presence in the Denver area business community. This consolidation resulted in a restructuring charge of approximately \$212 thousand in 2009 related to lease commitments and the write-off of leasehold improvements and other fixed assets. The remaining payments were made in the second quarter of 2010.

|                                      |                |
|--------------------------------------|----------------|
|                                      | (in thousands) |
| Balance as of December 31, 2009      | \$ 53          |
| Payments                             | (83)           |
| Adjustments to accrual               | 30             |
| <br>Balance as of September 30, 2010 | <br>\$         |

During the fourth quarter of 2009, the Company implemented a restructuring initiative to align its workforce and operating costs with current business opportunities within the ATS segment. The restructuring affected 33 employees.

|                                 |                |
|---------------------------------|----------------|
|                                 | (in thousands) |
| Balance as of December 31, 2009 | \$ 835         |

|                                  |    |       |
|----------------------------------|----|-------|
| Payments                         |    | (870) |
| Adjustments to accrual           |    | 44    |
| Balance as of September 30, 2010 | \$ | 9     |

**Table of Contents****Note 10. 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):

|                        | September<br>30,<br>2010 | December<br>31,<br>2009 |
|------------------------|--------------------------|-------------------------|
| Raw material           | \$ 17,551                | \$ 14,665               |
| Work in process        | 3,996                    | 3,480                   |
| Finished goods         | 67,656                   | 77,706                  |
| Total inventories, net | \$ 89,203                | \$ 95,851               |

**Note 11. Property, Plant and Equipment**

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

|  | September<br>30,<br>2010 | December<br>31,<br>2009 |
|--|--------------------------|-------------------------|
| Land                                     | \$ 2,612                 | \$ 2,612                |
| Building and leasehold improvements      | 23,450                   | 22,304                  |
| Machinery and equipment                  | 153,433                  | 139,023                 |
|  | 179,495                  | 163,939                 |
| Less: Accumulated depreciation           | (122,679)                | (106,744)               |
| Total property, plant and equipment, net | \$ 56,816                | \$ 57,195               |

**Note 12. 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 November 5, 2010, 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 the first nine months of 2010, ARRIS acquired \$19.0 million principal amount of the notes, which had a book value, net of debt discount, of \$15.7 million for approximately \$18.3 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.

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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 principal amount, unamortized discount and net carrying amount of the debt component were as follows (in thousands):

|                      | <b>September<br/>30,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|----------------------|-----------------------------------|----------------------------------|
| Principal amount     | \$ 242,050                        | \$ 261,050                       |
| Unamortized discount | (37,997)                          | (49,802)                         |
| Net carrying amount  | \$ 204,053                        | \$ 211,248                       |

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 and nine months ended September 30, 2010 and 2009 (in thousands):

|                                 | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------------|---|-------------|--|-------------|
|                                 | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Contractual interest recognized | \$1,253                                     | \$1,305     | \$3,854                                    | \$3,974     |
| Amortization of discount        | 2,781                                       | 2,772       | 8,548                                      | 8,308       |

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 September 30, 2010 and December 31, 2009 was \$2.1 million and \$2.8 million, respectively.

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

**Note 13. 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 and nine months ended September 30, 2010 and 2009 are as follows (in thousands):

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Net income                                      | \$ 14,042                                   | \$ 21,699   | \$ 52,807                                  | \$ 57,490   |
| Changes in the following equity accounts:       |   |             |  |             |
| Unrealized gain (loss) on marketable securities | (590)                                       | 101         | (402)                                      | 214         |
| Comprehensive income                            | \$ 13,452                                   | \$ 21,800   | \$ 52,405                                  | \$ 57,704   |

**Note 14. 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.

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The *Broadband Communications Systems* 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* 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* 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 and nine months ended September 30, 2010 and 2009 (in thousands):

|  | <b>BCS</b> | <b>ATS</b> | <b>MCS</b> | <b>Total</b> |
|--|------------|------------|------------|--------------|
| Three Months Ended September 30, 2010: |            |            |            |              |
| Net sales                              | \$ 203,772 | \$ 47,602  | \$ 22,912  | \$ 274,286   |
| Gross margin                           | 75,830     | 12,496     | 13,661     | 101,987      |
| Amortization of intangible assets      | 397        | 5,259      | 3,314      | 8,970        |
| Three Months Ended September 30, 2009: |            |            |            |              |
| Net sales                              | \$ 211,288 | \$ 45,488  | \$ 18,996  | \$ 275,772   |
| Gross margin                           | 94,317     | 10,650     | 10,506     | 115,473      |
| Amortization of intangible assets      | 18         | 5,654      | 3,609      | 9,281        |
| Nine Months Ended September 30, 2010:  |            |            |            |              |
| Net sales                              | \$ 629,516 | \$ 138,181 | \$ 53,641  | \$ 821,338   |
| Gross margin                           | 263,309    | 35,347     | 29,120     | 327,776      |
| Amortization of intangible assets      | 1,192      | 15,776     | 10,045     | 27,013       |
| Nine Months Ended September 30, 2009:  |            |            |            |              |
| Net sales                              | \$ 617,188 | \$ 131,946 | \$ 58,677  | \$ 807,811   |
| Gross margin                           | 265,952    | 29,733     | 32,578     | 328,263      |
| Amortization of intangible assets      | 18         | 16,962     | 10,827     | 27,807       |

The Company's gross intangible assets and goodwill by reportable segment as of September 30, 2010 has not materially changed from December 31, 2009.

**Table of Contents****Note 15. 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 and nine month periods ended September 30, 2010 and 2009 are set forth below (in thousands):

|                   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                   | 2010                                | 2009      | 2010                               | 2009      |
| Comcast           | \$74,582                            | \$101,975 | \$187,110                          | \$263,843 |
| % of sales        | 27.2%                               | 37.0%     | 22.8%                              | 32.7%     |
| Time Warner Cable | \$35,135                            | \$45,992  | \$129,096                          | \$147,959 |
| % of sales        | 12.8%                               | 16.7%     | 15.7%                              | 18.3%     |

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, Hungary and Israel. The Latin American market primarily includes Argentina, Brazil, Chile, Columbia, Mexico, Peru, Puerto Rico, Ecuador, Honduras, Costa Rica, Panama, Jamaica, and Bahamas. Sales to international customers were approximately \$97.2 million, or 35.4% of total sales, for the three months ended September 30, 2010. International sales during the same period in 2009 were \$79.0 million, or 28.7% of total sales. For the nine months ended September 30, 2010 and 2009 sales to international customers were \$298.6 million and \$220.2 million, or 36.4% and 27.3%, respectively.

**Note 16. 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<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                      | 2010                                | 2009     | 2010                               | 2009     |
| Basic:                               |                                     |          |                                    |          |
| Net income                           | \$14,042                            | \$21,699 | \$52,807                           | \$57,490 |
| Weighted average shares outstanding  | 125,237                             | 125,326  | 125,927                            | 124,381  |
| Basic earnings per share             | \$0.11                              | \$0.17   | \$0.42                             | \$0.46   |
| Diluted:                             |                                     |          |                                    |          |
| Net income                           | \$14,042                            | \$21,699 | \$52,807                           | \$57,490 |
| Weighted average shares outstanding  | 125,237                             | 125,326  | 125,927                            | 124,381  |
| Net effect of dilutive equity awards | 2,401                               | 4,369    | 3,176                              | 3,535    |
| Total                                | 127,638                             | 129,695  | 129,103                            | 127,916  |

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|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Diluted earnings per share | \$ 0.11 | \$ 0.17 | \$ 0.41 | \$ 0.45 |
|----------------------------|---------|---------|---------|---------|

The Company has \$242.1 million of convertible senior notes outstanding at September 30, 2010. 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 in 2010 and 2009 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 5.8 million shares and 3.8 million shares for the three and nine months ended September 30, 2010, respectively. During the same periods in 2009, approximately 2.1 million shares and 3.3 million shares, respectively, were excluded from the dilutive securities above. These exclusions are made if the exercise price of these options is

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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.

**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 March 2010, ARRIS repurchased 250 thousand shares of the Company's common stock at an average price of \$12.24 per share for an aggregate consideration of approximately \$3.1 million. In May 2010, ARRIS repurchased approximately 606 thousand shares of the Company's common stock at an average price of \$11.21 per share for an aggregate consideration of approximately \$6.8 million. In addition, in June 2010, ARRIS repurchased 1.3 million shares of the Company's common stock at an average price of \$10.65 per share for an aggregate consideration of approximately \$13.8 million. In the third quarter 2010, ARRIS repurchased approximately 1.7 million shares of the Company's common stock in September at an average price of \$9.30 per share for an aggregate consideration of approximately \$15.6 million. As of September 30, 2010, the remaining authorized amount for future repurchases was \$60.7 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 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. We operate our business in three segments:

Broadband Communications Systems ( BCS )

Access, Transport & Supplies ( ATS )

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, 2009.

**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 could potentially 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 and nine months ended September 30, 2010:

*Financial Highlights*

Sales during the three and nine months ended September 30, 2010 were \$274.3 million and \$821.3 million, respectively, compared to \$275.8 million and \$807.8 million in the same periods in 2009. The increase in sales for the first nine months is primarily attributable to higher sales of DOCSIS 3.0 EMTAs as operators are accelerating higher bandwidth services. This increase has been partially offset by lower CMTS sales as some operators, in particular Comcast, have completed a significant portion of their initial network upgrades necessary to launch DOCSIS 3.0 services. We anticipate that this trend will continue for the remainder of 2010.

Gross margin percentage was 37.2% in the third quarter, which compares to 41.9% in the third quarter 2009 and 40.4% in the second quarter 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).



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Through the first nine months of 2010 we have invested \$105.0 million in research and development, up \$15.6 million or approximately 17% from the same period in 2009. As stated previously, we made

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investments in new products, primarily in the IP video area, with the acquisitions of Digeo Inc. and EG Technology, Inc. in the second half of 2009.

We ended the third quarter 2010 with \$640.4 million of cash, cash equivalents and short-term investments. We generated approximately \$12.5 million of cash from operating activities in the third quarter 2010 and \$95.9 million during the first nine months of 2010.

During the three and nine months ended September 30, 2010, we repurchased 1.7 million and 3.8 million shares of our common stock, respectively. Year to date, we have used \$39.3 million of cash for share repurchases at an average price of \$10.25 per share.

During the three and nine months ended September 30, 2010, we used \$13.5 million and \$18.3 million of cash to retire \$14.0 million and \$19.0 million principal amount of our convertible debt respectively.

### *Product Line Highlights*

#### **Broadband Communications Systems**

##### **o CMTS**

Downstream port shipments were approximately 25 thousand in the third quarter of 2010 and 101 thousand through the first nine months of 2010.

Experienced a decline in sales as some key customers have completed a significant portion of their initial DOCSIS 3.0 network deployments. We anticipate a rebound in CMTS sales in 2011 as they consume capacity as a result of customer bandwidth consumption.

Announced availability of new 32D and 24U line cards which increases the capacity of current chassis.

Good progress on development of next generation Converged Edge Router CMTS product that will enable smooth transition of legacy video networks to IP.

##### **o CPE**

Approximately 1.8 million and 4.3 million CPE units were shipped in the third quarter and first nine months of 2010, respectively. Shipments of DOCSIS 3.0 CPE increased to 33.5% of the total unit shipments in the third quarter of 2010 as compared to 11.6% in the same quarter last year.

Maintained number one EMTA market share for 22 consecutive quarters (source: Infonetics)

The third quarter 2010 was our strongest quarter to date for the sales of data modems, advanced gateways and business services terminals.

Good progress on the development of our IP Multimedia gateway including the shipment of first lab trial units.

#### **Access, Transport & Supplies**

o Commercial RFoG deployment at top MSO.

o Multiple top international MSO EPON deployments.

o CORWave dual wavelength optical transmitter released to market.

o Growth in professional services.

#### **Media & Communications Systems**

o Sales in the third quarter were \$22.9 million, up year over year and sequentially. As expected, the increase in the third quarter 2010 reflects customer acceptances of certain key projects.

o Continued growth in ConvergeMedia Management suite VOD back office deployments across 13 MSOs.

- o Initial delivery of multi-screen on-demand application.

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**Table of Contents****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 and nine months ended September 30, 2010 and 2009 which detail and reconcile GAAP and Non-GAAP earnings per share:

| (in thousands, except per share data)   | Gross Margin | For the Three Months Ended September 30, 2010 |                  |                        |                    |           | Net Income |
|---|--------------|---|------------------|------------------------|--------------------|-----------|------------|
|   |              | Operating Expense                             | Operating Income | Other (Income) Expense | Income Tax Expense |           |            |
| GAAP  | \$ 101,987   | \$ 78,021                                     | \$ 23,966        | \$ 3,876               | \$ 6,048           | \$ 14,042 |            |
| Stock compensation expense  | 491          | (5,294)                                       | 5,785            |                        |                    | 5,785     |            |
| Acquisition costs, restructuring, and integration costs                                   |              |   |                  |                        |                    |           |            |
| Amortization of intangible assets   |              | (8,970)                                       | 8,970            |                        |                    | 8,970     |            |
| Non-cash interest expense   |              |   |                  | (2,781)                |                    | 2,781     |            |
| Gain on repurchase of debt  |              |   |                  | 263                    |                    | (263)     |            |
| Tax related to items above  |              |   |                  |                        | 6,133              | (6,133)   |            |
| Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items |              |   |                  |                        | 1,040              | (1,040)   |            |
| Non-GAAP  | \$ 102,478   | \$ 63,757                                     | \$ 38,721        | \$ 1,358               | \$ 13,221          | \$ 24,142 |            |
| GAAP net income per share diluted   |              |   |                  |                        |                    | \$ 0.11   |            |
| Non-GAAP net income per share diluted   |              |   |                  |                        |                    | \$ 0.19   |            |
| GAAP weighted average common shares diluted   |              |   |                  |                        |                    | 127,638   |            |
| Non-GAAP weighted average common shares diluted   |              |   |                  |                        |                    | 127,638   |            |

| (in thousands, except per share data) | Gross Margin | For the Nine Months Ended September 30, 2010 |                  |                        |                    |  | Net Income |
|---------------------------------------|--------------|--|------------------|------------------------|--------------------|--|------------|
|                                       |              | Operating Expense                            | Operating Income | Other (Income) Expense | Income Tax Expense |  |            |

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|   |            |            |            |           |           |           |
|---|------------|------------|------------|-----------|-----------|-----------|
| GAAP  | \$ 327,776 | \$ 235,616 | \$ 92,160  | \$ 11,871 | \$ 27,482 | \$ 52,807 |
| Stock compensation expense  | 1,405      | (14,654)   | 16,059     |           |           | 16,059    |
| Acquisition costs, restructuring, and integration costs                                   |            | (73)       | 73         |           |           | 73        |
| Amortization of intangible assets   |            | (27,013)   | 27,013     |           |           | 27,013    |
| Non-cash interest expense   |            |            |            | (8,548)   |           | 8,548     |
| Gain on repurchase of debt  |            |            |            | 378       |           | (378)     |
| Tax related to items above  |            |            |            |           | 17,808    | (17,808)  |
| Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items |            |            |            |           | 169       | (169)     |
| Non-GAAP  | \$ 329,181 | \$ 193,876 | \$ 135,305 | \$ 3,701  | \$ 45,459 | \$ 86,145 |
| GAAP net income per share diluted   |            |            |            |           |           | \$ 0.41   |
| Non-GAAP net income per share diluted   |            |            |            |           |           | \$ 0.67   |
| GAAP weighted average common shares diluted   |            |            |            |           |           | 129,103   |
| Non-GAAP weighted average common shares diluted   |            |            |            |           |           | 129,103   |

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| (in thousands, except per share data)   | Gross<br>Margin | For the Three Months Ended September 30, 2009 |                     |                              |                          |           | Net<br>Income |
|---|-----------------|---|---------------------|------------------------------|--------------------------|-----------|---------------|
|   |                 | Operating<br>Expense                          | Operating<br>Income | Other<br>(Income)<br>Expense | Income<br>Tax<br>Expense |           |               |
| GAAP  | \$ 115,473      | \$ 76,574                                     | \$ 38,899           | \$ 4,545                     | \$ 12,655                | \$ 21,699 |               |
| Stock compensation expense  | 394             | (3,866)                                       | 4,260               |                              |                          | 4,260     |               |
| Acquisition costs, restructuring, and integration costs                                   |                 | (348)   | 348                 |                              |                          | 348       |               |
| Amortization of intangible assets   |                 | (9,281)                                       | 9,281               |                              |                          | 9,281     |               |
| Non-cash interest expense   |                 |   |                     | (2,772)                      |                          | 2,772     |               |
| Tax related to items above  |                 |   |                     |                              | 6,218                    | (6,218)   |               |
| Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items |                 |   |                     |                              | 166                      | (166)     |               |
| Non-GAAP  | \$ 115,867      | \$ 63,079                                     | \$ 52,788           | \$ 1,773                     | \$ 19,039                | \$ 31,976 |               |
| GAAP net income per share diluted   |                 |   |                     |                              |                          | \$ 0.17   |               |
| Non-GAAP net income per share diluted   |                 |   |                     |                              |                          | \$ 0.25   |               |
| GAAP weighted average common shares diluted   |                 |   |                     |                              |                          | 129,695   |               |
| Non-GAAP weighted average common shares diluted   |                 |   |                     |                              |                          | 129,695   |               |

| (in thousands, except per share data)                   | Gross<br>Margin | For the Nine Months Ended September 30, 2009 |                     |                              |                          |           | Net<br>Income |
|---|-----------------|--|---------------------|------------------------------|--------------------------|-----------|---------------|
|   |                 | Operating<br>Expense                         | Operating<br>Income | Other<br>(Income)<br>Expense | Income<br>Tax<br>Expense |           |               |
| GAAP  | \$ 328,263      | \$ 228,821                                   | \$ 99,442           | \$ 10,099                    | \$ 31,853                | \$ 57,490 |               |
| Stock compensation expense                              | 1,063           | (10,651)                                     | 11,714              |                              |                          | 11,714    |               |
| Acquisition costs, restructuring, and integration costs |                 | (1,060)                                      | 1,060               |                              |                          | 1,060     |               |
| Amortization of intangible assets                       |                 | (27,807)                                     | 27,807              |                              |                          | 27,807    |               |
| Non-cash interest expense                               |                 |  |                     | (8,308)                      |                          | 8,308     |               |
| Gain on repurchase of debt                              |                 |  |                     | 4,152                        |                          | (4,152)   |               |
| Tax related to items above                              |                 |  |                     |                              | 15,186                   | (15,186)  |               |
|   |                 |  |                     |                              | (1,289)                  | 1,289     |               |

Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items

|          |            |            |            |          |           |           |
|----------|------------|------------|------------|----------|-----------|-----------|
| Non-GAAP | \$ 329,326 | \$ 189,303 | \$ 140,023 | \$ 5,943 | \$ 45,750 | \$ 88,330 |
|----------|------------|------------|------------|----------|-----------|-----------|

|                                   |  |  |  |  |  |         |
|-----------------------------------|--|--|--|--|--|---------|
| GAAP net income per share diluted |  |  |  |  |  | \$ 0.45 |
|-----------------------------------|--|--|--|--|--|---------|

|                                       |  |  |  |  |  |         |
|---------------------------------------|--|--|--|--|--|---------|
| Non-GAAP net income per share diluted |  |  |  |  |  | \$ 0.69 |
|---------------------------------------|--|--|--|--|--|---------|

|   |  |  |  |  |  |         |
|---|--|--|--|--|--|---------|
| GAAP weighted average common shares diluted |  |  |  |  |  | 127,916 |
|---|--|--|--|--|--|---------|

|   |  |  |  |  |  |         |
|---|--|--|--|--|--|---------|
| Non-GAAP weighted average common shares diluted |  |  |  |  |  | 127,916 |
|---|--|--|--|--|--|---------|

In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items mentioned below 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.

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Gain on retirement of debt ARRIS repurchased a portion of its convertible debt and recognized a gain of approximately \$0.3 million and \$0.4 million in the third quarter of 2010 and first nine months of 2010 respectively, and a gain of approximately \$4.2 million in the first quarter of 2009.

Adjustments of income taxes valuation allowances, R&D credits, and other discrete tax items Included in the third quarter 2010 was a net discrete tax benefit of \$1.0 million attributable to U.S. Federal return-to-provision adjustment in 2010. In the second quarter 2010, a net discrete tax benefit of \$0.3 million was recorded for certain federal deferred tax assets. Included in the first quarter 2010 was a discrete tax expense of \$1.2 million relating to state deferred tax assets. In the first quarter of 2009, a discrete tax expense of approximately \$1.5 million was recorded for state valuation allowances and research and development tax credits. Included in the third quarter 2009 was a net discrete tax benefit of \$0.2 million attributable to U.S. Federal return-to-provision adjustment in 2009.

**Significant Customers**

The vast majority of our sales are to cable system operators worldwide. As the U.S. cable industry continued a trend toward consolidation, the six largest MSOs controlled approximately 87.5% of the triple play Revenue Generating Units ( RGU ) within the U.S. cable market (according to Dataxis in the second quarter 2010), thereby making our sales to those MSOs critical to our success. Our sales are substantially dependent upon a system operator s selection of ARRIS network equipment, demand for increased broadband services by subscribers, and general capital expenditure levels by system operators. Our two 10% customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. From time-to-time, the affiliates included in our revenues from these customers 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 currently understood to be under common control. A summary of sales to these customers for the three and nine month periods ended September 30, 2010 and 2009 are set forth below (in thousands):

|                   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|-------------------|-------------------------------------|------------|------------------------------------|------------|
|                   | 2010                                | 2009       | 2010                               | 2009       |
| Comcast           | \$ 74,582                           | \$ 101,975 | \$ 187,110                         | \$ 263,843 |
| % of sales        | 27.2%                               | 37.0%      | 22.8%                              | 32.7%      |
| Time Warner Cable | \$ 35,135                           | \$ 45,992  | \$ 129,096                         | \$ 147,959 |
| % of sales        | 12.8%                               | 16.7%      | 15.7%                              | 18.3%      |

**Comparison of Operations for the Three and Nine Months Ended September 30, 2010 and 2009****Net Sales**

The table below sets forth our net sales for the three and nine months ended September 30, 2010 and 2009, for each of our segments (in thousands):

| Business Segment: | Net Sales            |            |                     |            | Increase (Decrease) Between 2010 and 2009 |       |                     |       |
|-------------------|----------------------|------------|---------------------|------------|---|-------|---------------------|-------|
|                   | For the Three Months |            | For the Nine Months |            | For the Three Months                      |       | For the Nine Months |       |
|                   | Ended September 30,  |            | Ended September 30, |            | Ended September 30                        |       | Ended September 30  |       |
|                   | 2010                 | 2009       | 2010                | 2009       | \$  | %     | \$                  | %     |
| BCS               | \$ 203,772           | \$ 211,288 | \$ 629,516          | \$ 617,188 | \$ (7,516)                                | (3.6) | \$ 12,328           | 2.0   |
| ATS               | 47,602               | 45,488     | 138,181             | 131,946    | 2,114                                     | 4.6   | 6,235               | 4.7   |
| MCS               | 22,912               | 18,996     | 53,641              | 58,677     | 3,916                                     | 20.6  | (5,036)             | (8.6) |
| Total sales       | \$ 274,286           | \$ 275,772 | \$ 821,338          | \$ 807,811 | \$ (1,486)                                | (0.5) | \$ 13,527           | 1.7   |





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The table below sets forth our domestic and international sales for the three and nine months ended September 30, 2010 and 2009 (in thousands):

|               | Net Sales            |            |                     |            | Increase (Decrease) Between 2010 and 2009 |        |                     |        |
|---------------|----------------------|------------|---------------------|------------|---|--------|---------------------|--------|
|               | For the Three Months |            | For the Nine Months |            | For the Three Months                      |        | For the Nine Months |        |
|               | Ended September 30,  |            | Ended September 30, |            | Ended September 30                        |        | Ended September 30  |        |
|               | 2010                 | 2009       | 2010                | 2009       | \$  | %      | \$                  | %      |
| Domestic      | \$ 177,069           | \$ 196,729 | \$ 522,716          | \$ 587,604 | \$ (19,660)                               | (10.0) | \$ (64,888)         | (11.0) |
| International | 97,217               | 79,043     | 298,622             | 220,207    | 18,174                                    | 23.0   | 78,415              | 35.6   |
| Total sales   | \$ 274,286           | \$ 275,772 | \$ 821,338          | \$ 807,811 | \$ (1,486)                                | (0.5)  | \$ 13,527           | 1.7    |

*Broadband Communication Systems Net Sales 2010 vs. 2009*

During the three months ended September 30, 2010, sales of our Broadband Communications Systems segment products decreased by approximately 3.6% as compared to the same period in 2009. This decline in sales is primarily the result of lower CMTS sales as some key customers have completed a significant portion of their initial DOCSIS 3.0 network deployments. The decline in CMTS was partially offset by higher CPE sales.

During the nine months ended September 30, 2010, sales of our Broadband Communications Systems segment products increased approximately 2.0% as compared to the same periods in 2009. This increase in sales primarily resulted from higher sales of the DOCSIS 3.0 EMTA products in 2010.

*Access, Transport & Supplies Net Sales 2010 vs. 2009*

During the three and nine months ended September 30, 2010 Access, Transport and Supplies segment revenue increased by approximately 4.6% and 4.7%, respectively, as compared to the same periods in 2009. The increase for the quarter reflects higher professional services sales. The increase for the nine months ended September 30, 2010 reflects higher professional services and a modest improvement in infrastructure spending.

*Media & Communication Systems Net Sales 2010 vs. 2009*

Media & Communications Systems revenue increased by approximately 20.6% in the third quarter of 2010 as compared to third quarter of 2009. The increase reflected customer acceptances of certain key projects.

Revenue decreased by 8.6% in the first nine months of the year as compared to the same periods in 2009. It is important to note that revenues for this segment can vary as revenue recognition is significantly associated with non-linear purchases of licenses and customer acceptance.

**Gross Margin**

The table below sets forth our gross margin for the three and nine months ended September 30, 2010 and 2009, for each of our reporting segments (in thousands):

| Business Segment: | Gross Margin \$      |           |                     |            | Increase (Decrease) Between 2010 and 2009 |        |                     |       |
|-------------------|----------------------|-----------|---------------------|------------|---|--------|---------------------|-------|
|                   | For the Three Months |           | For the Nine Months |            | For the Three Months                      |        | For the Nine Months |       |
|                   | Ended September 30,  |           | Ended September 30, |            | Ended September 30                        |        | Ended September 30  |       |
|                   | 2010                 | 2009      | 2010                | 2009       | \$  | %      | \$                  | %     |
| BCS               | \$ 75,830            | \$ 94,317 | \$ 263,309          | \$ 265,952 | \$ (18,487)                               | (19.6) | \$ (2,643)          | (1.0) |

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|       |            |            |            |            |             |        |          |        |
|-------|------------|------------|------------|------------|-------------|--------|----------|--------|
| ATS   | 12,496     | 10,650     | 35,347     | 29,733     | 1,846       | 17.3   | 5,614    | 18.9   |
| MCS   | 13,661     | 10,506     | 29,120     | 32,578     | 3,155       | 30.0   | (3,458)  | (10.6) |
| Total | \$ 101,987 | \$ 115,473 | \$ 327,776 | \$ 328,263 | \$ (13,486) | (11.7) | \$ (487) | (0.1)  |

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The table below sets forth our gross margin percentages for the three and nine months ended September 30, 2010 and 2009, for each of our business segments:

|                          | Gross Margin %       |       |                     |       | Increase (Decrease) Between<br>2010 and 2009 |                        |
|--------------------------|----------------------|-------|---------------------|-------|--|------------------------|
|                          | For the Three Months |       | For the Nine Months |       | For the Three<br>Months                      | For the Nine<br>Months |
|                          | Ended September 30,  |       | Ended September 30, |       | Ended<br>September<br>30                     | Ended<br>September 30  |
|                          | 2010                 | 2009  | 2010                | 2009  | Percentage Points                            |                        |
| <i>Business Segment:</i> |                      |       |                     |       |  |                        |
| BCS                      | 37.2%                | 44.6% | 41.8%               | 43.1% | (7.4)  | (1.3)                  |
| ATS                      | 26.3%                | 23.4% | 25.6%               | 22.5% | 2.9  | 3.1                    |
| MCS                      | 59.6%                | 55.3% | 54.3%               | 55.5% | 4.3  | (1.2)                  |
| Total                    | 37.2%                | 41.9% | 39.9%               | 40.6% | (4.7)  | (0.7)                  |

*Broadband Communications Systems Gross Margin 2010 vs. 2009*

Broadband Communications Systems segment gross margin percentage and dollars decreased during the three and nine months ended September 30, 2010 as compared to the same periods in 2009. The decrease primarily reflects a product mix change as we had higher EMTA sales and lower CMTS sales. EMTA products have a lower gross margin than CMTS products.

*Access, Transport & Supplies Gross Margin 2010 vs. 2009*

The Access, Transport & Supplies segment gross margin dollars and percentage increased year over year:

The increase in gross margin dollars was primarily the result of an increase in sales in both the three and nine month periods in 2010.

The increase in gross margin percentage was primarily the result of a change in product mix (higher gross margins for professional services and optics product lines) and cost reduction initiatives late in 2009 to align production-related activities with current levels of demand.

*Media & Communications Systems Gross Margin 2010 vs. 2009*

Media & Communications Systems segment gross margin dollars and percentage increased during the three months ended September 30, 2010 while decreased during the nine months ended September 30, 2010 as compared to the same periods in 2009. These changes in gross margin dollars were directly related to the change in revenue for those periods.

**Operating Expenses**

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

|                           | Operating Expenses      |           |                     |            | Increase (Decrease) Between 2010 and<br>2009 |         |                        |        |
|---------------------------|-------------------------|-----------|---------------------|------------|--|---------|------------------------|--------|
|                           | For the Three<br>Months |           | For the Nine Months |            | For the Three<br>Months                      |         | For the Nine<br>Months |        |
|                           | Ended September<br>30,  |           | Ended September 30, |            | Ended September<br>30                        |         | Ended September<br>30  |        |
|                           | 2010                    | 2009      | 2010                | 2009       | \$   | %       | \$                     | %      |
| SG&A                      | \$ 33,913               | \$ 36,311 | \$ 103,489          | \$ 110,782 | (2,398)                                      | (6.6)   | (7,293)                | (6.6)  |
| Research &<br>development | 35,138                  | 30,909    | 105,041             | 89,447     | 4,229  | 13.7    | 15,594                 | 17.4   |
| Restructuring<br>charges  |                         | 73        | 73                  | 785        | (73)   | (100.0) | (712)                  | (90.7) |

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|                                |           |           |            |            |          |       |          |       |
|--------------------------------|-----------|-----------|------------|------------|----------|-------|----------|-------|
| Amortization of<br>intangibles | 8,970     | 9,281     | 27,013     | 27,807     | (311)    | (3.4) | (794)    | (2.9) |
| Total                          | \$ 78,021 | \$ 76,574 | \$ 235,616 | \$ 228,821 | \$ 1,447 | (0.2) | \$ 6,795 | 3.0   |

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

The year over year decrease in SG&A expense reflects:

Lower variable compensation costs.

Lower legal expenses as a result of decreased costs associated with various patents and other litigation matters.

*Research & Development Expenses*

We continue to aggressively invest in research and development. In the second half of 2009, we chose to incrementally invest in development associated with Video IP products. As a result, we increased our workforce and acquired Digeo Inc. and EG Technology, Inc. These actions led to the year over year increases.

*Restructuring Charges*

On a quarterly basis, we review our existing restructuring accruals and make adjustments if necessary. For the three and nine month periods ending September 30, 2010, the restructuring charges were \$0 and \$73 thousand, respectively. For the three and nine month periods ending September 30, 2009, restructuring charges were \$73 thousand and \$785 thousand respectively.

*Amortization of Intangibles*

Intangibles amortization expense for the three months ended September 30, 2010 and 2009 was \$9.0 million and \$9.3 million, respectively. For the nine months ended September 30, 2010 and 2009, intangible amortization expense was \$27.0 million and \$27.8 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.

***Other Expense (Income)***

*Interest Expense*

Interest expense for the three months ended September 30, 2010 and 2009 was \$4.5 million and \$4.4 million respectively. For the nine months ended September 30, 2010 and 2009, interest expense was \$13.7 million and \$13.1 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 September 30, 2010 and 2009 were both \$0.4 million. During the nine months ended September 30, 2010 and 2009, interest income was \$1.5 million and \$1.2 million, respectively. The income reflects interest earned on cash, cash equivalents and short-term investments.

*Loss on Foreign Currency*

During the three months and nine months ended September 30, 2010, we recorded a foreign currency loss of approximately \$0.1 million and \$0.3 million, respectively. During the three and nine months ended September 30, 2009, we recorded a foreign currency loss of approximately \$1.1 million and \$3.6 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 exchange rates, primarily the euro.

**Table of Contents***Other Expense (Income)*

Other expense (income) for the three months ended September 30, 2010 and 2009 was \$0.3 million and \$(0.3) million, respectively. For the nine months ended September 30, 2010 and 2009, other expense (income) was \$0.1 million and \$(0.9) million, respectively.

*Income Taxes*

In the three and nine months ended September 30, 2010, we recorded income tax expense of \$6.0 million and \$27.5 million, respectively, as compared to \$12.7 million and \$31.9 million, respectively, in the same periods in 2009. The overall effective income tax rate, including all discrete items, for the nine months ending September 30, 2010, was 34.3%, compared to 35.7% for the first nine months of 2009.

The Company anticipates that the effective tax rate for full year 2010 for non-discrete items, excluding the potential benefit from research and development tax credit legislation, will be approximately 35%.

**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*

|  | Nine Months Ended September 30,      |            |
|--|--------------------------------------|------------|
|  | 2010                                 | 2009       |
|  | (in thousands, except DSO and turns) |            |
| <i>Key Working Capital Items</i>                   |                                      |            |
| Cash provided by operating activities              | \$ 95,941                            | \$ 171,204 |
| Cash, cash equivalents, and short-term investments | \$ 640,357                           | \$ 561,712 |
| Long-term U.S. treasury notes                      |                                      | \$ 15,041  |
| Accounts receivable, net                           | \$ 133,915                           | \$ 119,125 |
| Days Sales Outstanding ( DSOs )                    | 46                                   | 47         |
| Inventory  | \$ 89,203                            | \$ 100,024 |
| Inventory turns                                    | 7.3                                  | 5.6        |
| <br>   |                                      |            |
| <i>Convertible notes at face value</i>             | \$ 242,050                           | \$ 261,050 |
| <i>Convertible notes at book value</i>             | \$ 204,053                           | \$ 208,420 |
| <br>   |                                      |            |
| <i>Capital Expenditures</i>                        | \$ 17,127                            | \$ 14,327  |

*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 remained flat during the first nine months of 2010 as compared to 2009 as a result of higher sales and payment patterns of our customers. Looking forward, it is possible that our DSOs may increase dependent upon our customer mix and payment patterns, particularly if international sales increase.

Inventory at the end of the third quarter 2010 was \$10.8 million lower than the end of the third quarter in 2009.

Inventory turns in the first nine months of 2010 were 7.3 as compared to 5.6 in the same period of 2009. We anticipate we may have an increase in inventory levels of our BCS products in the fourth quarter 2010 to ensure adequate supply of EMTAs.

**Table of Contents***Summary of Current Liquidity Position and Potential for Future Capital Raising*

We believe our current liquidity position, where we have approximately \$640.4 million of cash, cash equivalents, and short-term investments on hand as of September 30, 2010, 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.

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 March 2010, ARRIS repurchased 250 thousand shares of the Company's common stock at an average price of \$12.24 per share for an aggregate consideration of approximately \$3.1 million. In May 2010, ARRIS repurchased approximately 606 thousand shares of the Company's common stock at an average price of \$11.21 per share for an aggregate consideration of approximately \$6.8 million. In addition, in June 2010, ARRIS repurchased 1.3 million shares of the Company's common stock at an average price of \$10.65 per share for an aggregate consideration of approximately \$13.8 million. In the third quarter 2010, ARRIS repurchased approximately 1.7 million shares of the Company's common stock in September at an average price of \$9.30 per share for an aggregate consideration of approximately \$15.6 million. As of September 30, 2010, the remaining authorized amount for future repurchases was \$60.7 million.

*Commitments*

Our contractual obligations are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009. There has been no material change to our contractual obligations during the first nine months of 2010.

*Cash Flow*

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

|                                       | For the Nine Months Ended<br>September 30, |            |
|---------------------------------------|--|------------|
|                                       | 2010                                       | 2009       |
| Cash provided by operating activities | \$ 95,941                                  | \$ 171,204 |
| Cash used in investing activities     | (188,517)                                  | (119,678)  |
| Cash used in financing activities     | (56,095)                                   | 375        |
| Net (decrease) increase in cash       | \$(148,671)                                | \$ 51,901  |

Operating Activities:

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

|  | For the Nine Months Ended<br>September 30, |           |
|--|--|-----------|
|  | 2010                                       | 2009      |
| Net income   | \$ 52,807                                  | \$ 57,490 |
| Adjustments to reconcile net income to cash provided by operating activities | 68,626                                     | 70,748    |
| Net income including adjustments   | 121,433                                    | 128,238   |
| Decrease in accounts receivable  | 9,710                                      | 40,801    |
| Decrease in inventory  | 6,648                                      | 30,449    |
| Decrease in accounts payable and accrued liabilities                         | (42,226)                                   | (32,620)  |
| All other net  | 376  | 4,336     |



|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Cash provided by operating activities | \$ 95,941 | \$171,204 |
|---------------------------------------|-----------|-----------|

**Table of Contents***Net Income Including Adjustments*

Net income, including adjustments, decreased \$6.8 million during the first nine months of 2010 as compared to 2009. The adjustments to reconcile net income to cash provided by operating activities in total were down approximately \$2.1 million year over year, comprised of the following primary differences:

Net deferred tax assets decreased by \$2.6 million during the first nine months of 2010 as compared to a net decrease in the net deferred tax assets of \$13.7 million during the first nine months of 2009.

We recognized a gain of \$0.4 million associated with the redemption of a portion of our convertible debt during the first nine months of 2010 as compared to a gain of \$4.2 million in the first nine months of 2009.

The excess income tax benefits from stock-based compensation plans was \$2.7 million during the first nine months of 2010 as compared to \$2.0 million during the same period last year

Stock compensation expense during the first nine months of 2010 was \$16.1 million as compared to \$11.7 million during the same period in 2009.

Depreciation expense increased approximately \$1.5 million during the nine months ended September 30, 2010, as compared to the same period in 2009.

*Change in Accounts Receivable*

Accounts receivable decreased in the first nine months of 2010 and 2009. These decreases were primarily related to timing and payment patterns of our customers.

*Change in Inventory*

Inventory decreased in the first nine months of 2010 and 2009. The decrease was due primarily to timing of purchases.

*Change in Accounts Payable and Accrued Liabilities*

Declines in accounts payable and accrued liabilities in both years reflect the payment of annual bonuses in the first quarter coupled with normal timing variations associated with payment of accounts payable.

*All Other Net*

All other net includes the changes in other receivables, income taxes payable (recoverable), and prepaids and other, net. The other receivables represent amounts due from our contract manufacturers for material used in the assembly of our finished goods. The change in our income taxes recoverable account is a result of the timing of the actual estimated tax payments during the year as compared to the actual tax liability for the year.

**Investing Activities:**

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

|  | For the Nine Months Ended<br>September 30, |             |
|--|--|-------------|
|  | 2010                                       | 2009        |
| Capital expenditures                                     | \$ (17,127)                                | \$ (14,327) |
| Cash paid for acquisition, net of cash acquired          |  | (8,130)     |
| Cash proceeds from sale of property, plant and equipment | 243  | 208         |
| Purchases of investments                                 | (331,547)                                  | (151,845)   |
| Sales of investments                                     | 159,914                                    | 54,416      |
| Cash used in investing activities                        | \$(188,517)                                | \$(119,678) |

**Table of Contents***Capital Expenditures*

Capital expenditures are mainly for test equipment, manufacturing equipment, leasehold improvements, computer equipment, and business application software. We anticipate investing approximately \$20 million in fiscal year 2010.

*Cash Paid for Acquisition*

This represents the cash payments made in 2009 related to the C-COR, Digeo and EG Technologies acquisitions, net of cash acquired.

*Purchases and Sales of Investments*

These represent purchases and disposals of investment securities.

**Financing Activities:**

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

|  | For the Nine Months Ended<br>September 30, |          |
|--|--|----------|
|  | 2010                                       | 2009     |
| Payment of debt obligations                                    | \$ (112)                                   | \$ (121) |
| Early retirement of long-term debt                             | (18,331)                                   | (10,556) |
| Repurchase of common stock                                     | (39,288)                                   |          |
| Excess income tax benefits from stock-based compensation plans | 2,683                                      | 2,027    |
| Repurchase of shares to satisfy tax withholdings               | (6,422)                                    | (2,180)  |
| Proceeds from issuance of common stock, net                    | 5,375                                      | 11,205   |
| <br>   |  |          |
| Cash (used in) provided by financing activities                | \$ (56,095)                                | \$ 375   |

*Payment of Debt Obligation*

This represents the payment of the short term loan to the Pennsylvania Industrial Development Authority (PIDA) for the cost of expansion of the facility in State College, Pennsylvania. The PIDA borrowing has an interest rate of 2%. Monthly payments of principal and interest of approximately \$13 thousand are required through 2010.

*Early Retirement of Long-Term Debt*

During the first quarter of 2009, we purchased \$15.0 million of face value of our convertible debt for approximately \$10.6 million. The Company also wrote off approximately \$0.2 million of deferred finance fees associated with the portion of the notes retired. The Company realized a gain of approximately \$4.2 million on the retirement of the convertible debt. During the second quarter of 2010, we purchased \$5.0 million of face value of the convertible debt for approximately \$4.8 million. We purchased additional \$14.0 million of face value of the convertible debt for approximately \$13.5 million in the third quarter of 2010. For the nine months ended September 30, 2010, the Company wrote off approximately \$0.2 million of deferred finance fees associated with the portion of the notes acquired.

*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. We did not repurchase any shares under the Plan during 2009.

In March 2010, ARRIS repurchased 250 thousand shares of the Company's common stock at an average price of \$12.24 per share for an aggregate consideration of approximately \$3.1 million. In May 2010, ARRIS repurchased approximately 606 thousand shares of the Company's common stock at an average price of \$11.21 per share for an aggregate consideration of approximately \$6.8 million. In addition, in June 2010, ARRIS repurchased 1.3 million shares of the Company's common stock at an average price of \$10.65 per share for an aggregate consideration of approximately \$13.8 million. In the third quarter 2010, ARRIS repurchased approximately 1.7 million shares of the Company's common stock in September at an average price of \$9.30 per share for an

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aggregate consideration of approximately \$15.6 million. As of September 30, 2010, the remaining authorized amount for future repurchases was \$60.7 million.

*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.

*Interest Rates*

As of September 30, 2010, 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 Mexico, Taiwan, China, Ireland, and other foreign countries. 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 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. We had approximately \$4.5 million outstanding of cash collateral at September 30, 2010 and December 31, 2009.

*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 held certain investments in the common stock of publicly-traded companies, which were classified as available-for-sale. As of September 30, 2010 and December 31, 2009 our holdings in these investments were \$5.0 million and zero, respectively. Changes in the market value of these securities are

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typically recorded in other comprehensive income and gains or losses on related sales of these securities are recognized in income.

The Company has 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 key executives of the Company. 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, which was available to certain 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.

The Company also has a deferred retirement salary plan, which was limited to certain current or former officers of C-COR. We hold investments to cover the liability.

In the third quarter of 2009, the Company began funding 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 \$17.1 million in the first nine months of 2010 as compared to \$14.3 million in the first nine months of 2009. Management expects to invest approximately \$20 million in capital expenditures for the fiscal year 2010.

**Critical Accounting Policies and Estimates**

The accounting and financial reporting policies of the 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, 2009, as filed with the SEC. With the exception of the recent adoption of an accounting pronouncement related to revenue recognition, as discussed below, our critical accounting estimates have not changed in any material respect during the nine months ended September 30, 2010.

*Revenue Recognition*

ARRIS generates revenue as a result of varying activities, including the delivery of stand-alone equipment, custom design and installation services, and bundled sales arrangements inclusive of equipment, software and services. The revenue from these activities is recognized in accordance with applicable accounting guidance and their related interpretations.

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Revenue is recognized when all of the following criteria have been met:

*When persuasive evidence of an arrangement exists.* Contracts and customer purchase orders are used to determine the existence of an arrangement.

*Delivery has occurred.* Shipping documents, proof of delivery and customer acceptance (when applicable) are used to verify delivery.

*The fee is fixed or determinable.* Pricing is considered fixed and determinable at the execution of a customer arrangement, based on specific products and quantities to be delivered at specific prices. This determination includes a review of the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment or future discounts.

*Collectability is reasonably assured.* The Company assesses the ability to collect from customers based on a number of factors that include information supplied by credit agencies, analyzing customer accounts, reviewing payment history and consulting bank references. Should a circumstance arise where a customer is deemed not creditworthy, all revenue related to the transaction will be deferred until such time that payment is received and all other criteria to allow the Company to recognize revenue have been met.

Revenue is deferred if any of the above revenue recognition criteria is not met as well as when certain circumstances exist for any of our products or services, including, but not limited to:

When undelivered products or services that are essential to the functionality of the delivered product exist, revenue is deferred until such undelivered products or services are delivered as the customer would not have full use of the delivered elements.

When required acceptance has not occurred.

When trade-in rights are granted at the time of sale, that portion of the sale is deferred until the trade-in right is exercised or the right expires. In determining the deferral amount, management estimates the expected trade-in rate and future value of the product upon trade-in. These factors are periodically reviewed and updated by management, and the updates may result in either an increase or decrease in the deferral.

*Equipment* We provide cable system operators with equipment that can be placed within various stages of a broadband cable system that allows for the delivery of cable telephony, video and high speed data as well as outside plant construction and maintenance equipment. For equipment sales, revenue recognition is generally established when the products have been shipped, risk of loss has transferred, objective evidence exists that the product has been accepted, and no significant obligations remain relative to the transaction. Additionally, based on historical experience, we have established reliable estimates related to sales returns and other allowances for discounts. These estimates are recorded as a reduction to revenue at the time the revenue is initially recorded.

*Software Sold Without Tangible Equipment* We sell internally developed software as well as software developed by outside third parties that does not require significant production, modification or customization. For arrangements that contain only software and the related post-contract support, we recognize revenue in accordance with the applicable software revenue recognition guidance. If the arrangement includes multiple elements that are software only, then the software revenue recognition guidance is applied and the fee is allocated to the various elements based on VSOE of fair value. If sufficient VSOE of fair value does not exist for the allocation of revenue to all the various elements in a multiple element software arrangement, all revenue from the arrangement is deferred until the earlier of the point at which such sufficient VSOE of fair value is established or all elements within the arrangement are delivered. If VSOE of fair value exists for all undelivered elements, but does not exist for one or more delivered elements, the arrangement consideration is allocated to the various elements of the arrangement using the residual method of accounting. Under the residual method, the amount of the arrangement consideration allocated to the delivered elements is equal to the total arrangement consideration less the aggregate fair value of the undelivered elements. Under the residual method, if VSOE exists for the undelivered element, generally PCS, the fair value of the

undelivered element is deferred and recognized ratably over the term of the PCS contract, and the remaining portion of the arrangement is recognized as revenue upon

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delivery. If sufficient VSOE of fair value does not exist for post-contract support, revenue is recognized ratably over the term of support.

*Standalone Services* Installation, training, and professional services are generally recognized in service revenues when performed.

*Incentives* Customer incentive programs that include consideration, primarily rebates/credits to be used against future product purchases and certain volume discounts, have been recorded as a reduction of revenue when the shipment of the requisite equipment occurs.

*Value Added Resellers* We employ the sell-in method of accounting for revenue when using a Value Added Reseller ( VAR ) as our channel to market. Because product returns are restricted, revenue under this method is recognized at the time of shipment to the VAR provided all criteria for recognition are met.

*Multiple Element Arrangements* Certain customer transactions may include multiple deliverables based on the bundling of equipment, software and services. When a multiple-element arrangement exists, the fee from the arrangement is allocated to the various deliverables, to the extent appropriate, so that the proper amount can be recognized as revenue as each element is delivered. Based on the composition of the arrangement, we analyze the provisions of the accounting guidance to determine the appropriate model that is applied towards accounting for the multiple-element arrangement. If the arrangement includes a combination of elements that fall within different applicable guidance, we follow the provisions of the hierarchical literature to separate those elements from each other and apply the relevant guidance to each.

For multiple element arrangements that include software or have a software-related element that is essential to the functionality of the tangible product, more than incidental but that does not involve significant production, modification or customization, we apply, and will continue to apply, the provisions of the relevant software revenue recognition accounting guidance for arrangements originating before January 1, 2010 that continue to be effective after January 1, 2010.

For multiple element arrangements that include software or have a software-related element that is more than incidental and does involve significant production, modification or customization, revenue is recognized using the contract accounting guidelines by applying the percentage of completion or completed contract method. We recognize software license and associated professional services revenue for its mobile workforce management software license product installations using the percentage-of-completion method of accounting as we believe that its estimates of costs to complete and extent of progress toward completion of such contracts are reliable. For certain software license arrangements where professional services are being provided and are deemed to be essential to the functionality or are for significant production, modification, or customization of the software product, both the software and the associated professional service revenue are recognized using the completed-contract method if we do not have the ability to reasonably estimate contract costs at the inception of the contracts. Under the completed-contract method, revenue is recognized when the contract is complete, and all direct costs and related revenues are deferred until that time. The entire amount of an estimated loss on a contract is accrued at the time a loss on a contract is projected. Actual profits and losses may differ from these estimates.

If the arrangement includes multiple elements, the fee is allocated to the various elements based on VSOE of fair value. If sufficient VSOE of fair value does not exist for the allocation of revenue to all the various elements in a multiple element arrangement, all revenue from the arrangement is deferred until the earlier of the point at which such sufficient VSOE is established or all elements within the arrangement are delivered. If VSOE of fair value exists for all undelivered elements, but does not exist for one or more delivered elements, the arrangement consideration is allocated to the various elements of the arrangement using the residual method of accounting. Under the residual method, the amount of the arrangement consideration allocated to the delivered elements is equal to the total arrangement consideration less the aggregate fair value of the undelivered elements. Using this method, any potential discount on the arrangement is allocated entirely to the delivered elements, which ensures that the amount of revenue recognized at any point in time is not overstated. Under the residual method, if VSOE exists for the undelivered element, generally PCS, the fair value of the undelivered element is deferred and recognized ratably over the term of the PCS contract, and the remaining portion of the arrangement is recognized as revenue upon delivery, which generally occurs upon delivery of the product or implementation of the system. License revenue allocated to software



products, in certain circumstances, is recognized upon delivery of the software products.

Many of our products are sold in combination with customer support and maintenance services, which consist of software updates and product support. Software updates provide customers with rights to unspecified software updates that we choose to develop and to maintenance releases and patches that we choose to release during the period of the support period. Product support services include telephone support, remote diagnostics, email and

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web access, access to on-site technical support personnel and repair or replacement of hardware in the event of damage or failure during the term of the support period. Maintenance and support service fees are recognized ratably under the straight-line method over the term of the contract, which is generally one year. We do not record receivables associated with maintenance revenues without a firm, non-cancelable order from the customer. VSOE of fair value is determined based on the price charged when the same element is sold separately and based on the prices at which our customers have renewed their customer support and maintenance. For elements that are not yet being sold separately, the price established by management, if it is probable that the price, once established, will not change before the separate introduction of the element into the marketplace is used to measure VSOE of fair value for that element. We elected to early adopt accounting standards on a prospective basis related to multiple element arrangements as discussed in Note 2 of the Notes to the Consolidated Financial Statements. We apply the previous applicable accounting guidance for arrangements originating prior to the adoption date of January 1, 2010. Below is a comparison of: 1) units of accounting, 2) allocation of arrangement consideration and 3) timing of revenue recognition applying the old and new guidance.

***Units of Accounting:***

**Before January 1, 2010:** For multiple element arrangements originating before January 1, 2010, the deliverables are separated into more than one unit of accounts when the following criteria are met: (i) the delivered element(s) have value to the customer on a stand-alone basis, (ii) objective and reliable evidence of fair value exists for the undelivered element(s), and (iii) delivery of the undelivered element(s) is probable and substantially in the control of the Company.

**After December 31, 2009:** For multiple element arrangements (other than software sold without tangible equipment) originating or materially modified after December 31, 2009, the deliverables are separated into more than one unit of accounting when the following criteria are met: (i) the delivered element(s) have value to the customer on a stand-alone basis, and (ii) if a general right of return exists relative to the delivered item, delivery or performance of the undelivered element(s) is probable and substantially in the control of ARRIS.

***Allocation of Arrangement Consideration:***

**Before January 1, 2010:** Revenue is then allocated to each unit of accounting based on the relative fair value of each accounting unit or by using the residual method if objective evidence of fair value does not exist for the delivered element(s).

**After December 31, 2009:** We use BESP of the element(s) for the allocation of arrangement consideration when unable to establish VSOE or TPE. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. BESP is generally used for new or highly customized offerings and solutions or elements not priced within a narrow range. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, geographies, market conditions, competitive landscape, internal costs, gross margin objectives, and pricing practices. We use the relative selling price basis for the allocation of the arrangement consideration.

The adoption of the new revenue recognition accounting policy resulted in an increase in revenue of approximately \$1 million and \$2 million for the three and nine months ended September 30, 2010, respectively.

**Table of Contents****Forward-Looking Statements**

Certain information and statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this report, including statements using terms such as may, expect, anticipate, intend, estimate, believe, plan, continue, could be, or similar variations or the negative thereof, forward-looking statements with respect to the financial condition, results of operations, and business of ARRIS, including statements that are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and management's beliefs and assumptions regarding these markets. These and any other statements in this document that are not statements about historical facts are forward-looking statements. We caution investors that forward-looking statements made by us are not guarantees of future performance and that a variety of factors could cause our actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Important factors that could cause results or events to differ from current expectations are described in the risk factors set forth in Item 1A, Risk Factors. These factors are not intended to be an all-encompassing list of risks and uncertainties that may affect the operations, performance, development and results of our business. In providing forward-looking statements, ARRIS expressly disclaims any obligation to update publicly or otherwise these statements, whether as a result of new information, future events or otherwise except to the extent required by law.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to various market risks, including interest rates and foreign currency rates. The following discussion of our risk-management activities includes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements.

We have had investments in auction rate securities that are classified as trading securities. Although these securities have maturity dates of 15 to 30 years, they have characteristics of short-term investments as the interest rates reset every 7, 28, or 35 days and we have the potential to liquidate them in an auction process. Due to the short duration of these investments, a movement in market interest rates would not have a material impact on our operating results. However, it is possible that a security will fail to reprice at the scheduled auction date. In these instances, we are entitled to receive a penalty interest rate above market and the auction rate security will be held until the next scheduled auction date. Due to the current market conditions and the failure of the auction rate security to reprice, beginning in the second quarter of 2008, we recorded changes in the fair value of the instrument as an impairment charge in the Statement of Operations in the gain (loss) on investment line. We successfully liquidated at par \$2.1 million of the auction rate security during first quarter of 2010. During the second quarter, ARRIS sold at par the remaining \$2.9 million of the auction rate security.

A significant portion of our products are manufactured or assembled in China, Mexico, Ireland, Taiwan, and other countries outside the United States. 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. Changes in the monetary exchange rates may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The euro is the predominant currency of those customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the euro versus the dollar, a hypothetical 10% weakening of the U.S. dollar (as of September 30, 2010) would provide a gain on foreign currency of approximately \$1.0 million. Conversely, a hypothetical 10% strengthening of the U.S. dollar would provide a loss on foreign currency of approximately \$1.0 million. There were no material changes in this market risk since December 31, 2009. The actual impact of foreign exchange rate changes will depend on, among other factors, the timing of rate changes and changes in the volume and mix of the our business. As of September 30, 2010, we had no material contracts, other than accounts receivable, denominated in foreign currencies.

We regularly review our forecasted sales in Euros and enter into option contracts when appropriate. In the event that we determine a hedge to be ineffective prior to expirations earnings may be effected by the change in the

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hedge value. As of September 30, 2010, we had option collars outstanding with notional amounts totaling 6.0 million Euros, which mature in 2010 and 10.5 million Euros maturing in 2011. As of September 30, 2010, we had no forward contracts outstanding. The fair value of these option collars was a net liability of approximately \$1.1 million as of September 30, 2010.

**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.

**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. 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.

In January and February 2008, Verizon Services Corp. filed separate lawsuits against Cox and Charter alleging infringement of eight patents. In the Verizon v. Cox suit, the jury issued a verdict in favor of Cox, finding non-infringement in all patents and invalidating two of Verizon's patents. Verizon filed a notice of appeal. The Charter suit is still pending, with trial anticipated for 2010. It is premature to assess the likelihood of a favorable outcome of the Charter case or Cox appeal, though the Cox outcome at trial increases the likelihood of a favorable Charter 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.

V-Tran Media Technologies filed a number of patent infringement lawsuits against 21 different parties, including suits against Comcast, Charter, Verizon, Time Warner and numerous smaller MSOs, for the alleged infringement of two patents related to a television broadcast system for selective transmission of viewer chosen programs at viewer requested times. Both patents expired in June 2008. The defendants received a favorable Markman ruling. A summary judgment motion was granted in favor of the defendants, however additional discovery has been granted to the plaintiffs. Plaintiffs have updated their infringement claim in light of the Markman Ruling. ARRIS video on demand products sold prior to the expiration of the patents are the allegedly infringing products. It is premature to assess the likelihood of a final favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the defendants or pay royalties on products sold prior to the expiration of the patents. Since the patents have expired, Plaintiffs cannot prevent ARRIS from using the technology.

On March 11, 2009, ARRIS filed a declaratory judgment action against British Telecom (BT) seeking to invalidate certain BT patents and seeking a declaration that neither the ARRIS products, nor their use by ARRIS customers infringe any of the BT patents. This action arose from the assertion by BT (via their agent, IPValue), that the ARRIS products or their use by ARRIS customers infringed four BT patents. The suit was dismissed on the defendant's motion. ARRIS has appealed the lower court dismissal. On August 5, 2010, BT sued Cox and Cable One for infringement of the same four patents. ARRIS has been asked to indemnify Cox and Cable One. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS could be required to indemnify Cox and Cable One, pay royalties or cease utilizing certain technologies.

On July 31, 2009, ARRIS filed a motion for contempt in the U.S. District Court for the District of Delaware against SeaChange International related to a patent owned by ARRIS. In its motion, ARRIS is seeking further sanctions and the enforcement of the permanent injunction entered by the Court against certain of SeaChange



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products sold since 2002. The original finding of infringement was affirmed by the Federal Circuit in 2006, and the patent claims (with one exception) were upheld by the U.S. Patent Office in a re-examination process initiated by SeaChange. In response to ARRIS Motion for Contempt, on August 3, 2009, SeaChange filed a complaint seeking a declaratory judgment from the Court to declare that its products are non-infringing with respect to the patent. The Court has stayed the SeaChange declaratory judgment action and discovery is proceeding on the original ARRIS motion for contempt, sanctions and enforcement of the injunction. A hearing has been set for March 1, 2011.

On August 6, 2010, Ceres Communications sued 23 parties including several large MSO customers asserting infringement of a single patent. ARRIS has not been sued but may be asked to indemnify. On July 27, 2010, PACid filed suit against 87 companies including ARRIS and several MSOs for patent infringement related to two patents. ARRIS has filed an answer with respect to the PACid case. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify certain customers, pay royalties or cease utilizing certain technologies.

From time to time third parties approach ARRIS or an ARRIS customer, seeking that ARRIS or its customer consider entering into a license agreement for such patents. Such invitations cause ARRIS to dedicate time to study such patents and enter into discussions with such third parties regarding the merits and value, if any, of the patents. These discussions, may materialize into license agreements or patents asserted against ARRIS or its customers. If asserted against our customers, our customers may seek indemnification from ARRIS. It is not possible to determine the impact of any such ongoing discussions on ARRIS business financial conditions.

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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, have affected the market values of domestic cable operators and may impact their access to capital in the future. Even if the financial health of our customers remains intact, we cannot assure you that 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

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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 are also 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 and wireless PDA devices 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, in particular, telephony. 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.

***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



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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 \$235.1 million as of September 30, 2010, 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 implied fair value of the corresponding reporting unit's goodwill is less than the carrying value of the goodwill, we record an impairment. 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 or during the nine months of 2010. 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, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Form 10-K for the year ended December 31, 2009, as filed with the SEC.

***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 nine months ended September 30, 2010, sales to Comcast accounted for approximately 22.8% and sales to Time Warner Cable accounted for approximately 15.7% 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 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 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 and plan accordingly.

***Fluctuations in our Media & Communications Systems sales 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. 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



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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.

***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:

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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

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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 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 Amended and Restated 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.

**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 |

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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: November 5, 2010

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