

ARRIS GROUP INC  
Form 10-Q  
August 06, 2012  
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UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

**For the quarter ended June 30, 2012**

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 July 31, 2012, 113,246,428 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 Six Months Ended June 30, 2012**

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**Table of Contents****PART I. CONDENSED FINANCIAL INFORMATION****Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****ARRIS GROUP, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data) (unaudited)

	<u>June 30,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 199,395	\$ 235,875
Short-term investments, at fair value	340,166	282,904
Total cash, cash equivalents and short-term investments	539,561	518,779
Restricted cash	3,942	4,101
Accounts receivable (net of allowances for doubtful accounts of \$1,515 in 2012 and \$1,443 in 2011)	179,371	152,437
Other receivables	1,414	8,789
Inventories (net of reserves of \$9,953 in 2012 and \$12,243 in 2011)	102,361	115,912
Prepays	12,124	10,408
Current deferred income tax assets	21,972	22,048
Other current assets	16,766	27,071
Total current assets	877,511	859,545
Property, plant and equipment (net of accumulated depreciation of \$142,212 in 2012 and \$130,331 in 2011)	56,175	61,375
Goodwill	194,626	194,542
Intangible assets (net of accumulated amortization of \$224,197 in 2012 and \$209,374 in 2011)	110,000	124,823
Investments	70,967	71,095
Noncurrent deferred income tax assets	47,228	38,433
Other assets	10,575	10,997
	\$ 1,367,082	\$ 1,360,810
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 44,800	\$ 40,671
Accrued compensation, benefits and related taxes	28,165	36,764
Accrued warranty	2,995	3,350
Deferred revenue	63,023	43,746
Other accrued liabilities	23,980	33,325
Total current liabilities	162,963	157,856
Long-term debt, net of current portion	215,823	209,766
Accrued pension	25,696	25,260
Noncurrent income tax liability	26,676	24,450
Noncurrent deferred income tax liabilities	340	337
Other noncurrent liabilities	24,797	26,936
Total liabilities	456,295	444,605

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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; 113.6 million and 114.8 million shares issued and outstanding in 2012 and 2011, respectively	1,473	1,449
Capital in excess of par value	1,259,946	1,245,115
Treasury stock at cost, 33.4 million and 29.8 million shares in 2012 and 2011	(295,960)	(254,409)
Accumulated deficit	(44,468)	(65,268)
Unrealized gain (loss) on marketable securities (net of accumulated tax expense of \$390 in 2012 and \$119 in 2011)	211	(267)
Unfunded pension liability (net of accumulated tax effect of \$3,257 in 2012 and 2011)	(10,231)	(10,231)
Cumulative translation adjustments	(184)	(184)
Total stockholders' equity	910,787	916,205
	\$ 1,367,082	\$ 1,360,810

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****ARRIS GROUP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data and percentages) (unaudited)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net sales:				
Products	\$ 303,752	\$ 228,635	\$ 569,022	\$ 463,581
Services	45,575	37,164	83,205	69,654
Total net sales	349,327	265,799	652,227	533,235
Cost of sales:				
Products	210,016	140,259	385,139	293,014
Services	20,785	18,642	39,654	36,377
	230,801	158,901	424,793	329,391
Gross margin	118,526	106,898	227,434	203,844
Operating expenses:				
Selling, general and administrative expenses	40,135	35,868	79,678	72,706
Research and development expenses	42,881	36,629	87,028	72,669
Restructuring charges	1,039		6,242	
Acquisition costs	102		709	
Loss on sale of product line			337	
Amortization of intangible assets	7,444	8,944	14,823	17,888
Total operating expenses	91,601	81,441	188,817	163,263
Operating income	26,925	25,457	38,617	40,581
Other expense (income):				
Interest expense	4,422	4,180	8,772	8,405
Loss (gain) on investments	356	(334)	(605)	(757)
Interest income	(729)	(886)	(1,484)	(1,664)
Loss on foreign currency	540	79	1,348	967
Other income, net	(226)	(419)	(662)	(532)
Income from operations before income taxes	22,562	22,837	31,248	34,162
Income tax expense	7,561	6,147	10,448	5,908
Net income	\$ 15,001	\$ 16,690	\$ 20,800	\$ 28,254
Net income per common share:				
Basic	\$ 0.13	\$ 0.14	\$ 0.18	\$ 0.23
Diluted	\$ 0.13	\$ 0.13	\$ 0.18	\$ 0.23
Weighted average common shares:				
Basic	113,842	121,800	114,457	122,047

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Diluted	115,111	123,711	116,352	124,720
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See accompanying notes to the condensed consolidated financial statements.

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**ARRIS GROUP, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands) (unaudited)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income	\$ 15,001	\$ 16,690	\$ 20,800	\$ 28,254
Unrealized gain on marketable securities, net of tax expense of \$44 and \$654 for the three months ended June 30, 2012 and 2011, and \$271 and \$654 for the six months ended June 30, 2012 and 2011, respectively	62	286	478	1,138
Comprehensive income, net of tax	\$ 15,063	\$ 16,976	\$ 21,278	\$ 29,392

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****ARRIS GROUP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands) (unaudited)

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
Operating activities:		
Net income	\$ 20,800	\$ 28,254
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	14,177	11,668
Amortization of intangible assets	14,823	17,888
Stock compensation expense	14,516	11,209
Deferred income tax benefit	(9,720)	(11,403)
Amortization of deferred finance fees	320	326
Provision for doubtful accounts	54	
Gain on investments	(605)	(757)
Loss on disposal of product line	337	
Loss on disposal of fixed assets	6	33
Excess income tax benefits from stock-based compensation plans	(2,460)	(3,247)
Non-cash interest expense	6,057	5,721
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	(27,743)	(26,503)
Other receivables	7,393	6,117
Inventories	9,996	(11,257)
Income taxes payable and recoverable	8,452	12,591
Accounts payable and accrued liabilities	5,136	(15,480)
Prepays and other, net	4,327	2,649
Net cash provided by operating activities	65,866	27,809
Investing activities:		
Purchases of property, plant and equipment	(9,256)	(12,547)
Cash proceeds from sale of property, plant and equipment		43
Purchases of investments	(140,353)	(142,841)
Sales of investments	83,161	179,431
Cash proceeds from sale of product line	3,249	
Net cash (used in) provided by investing activities	(63,199)	24,086
Financing activities:		
Repurchase of common stock	(41,551)	(57,647)
Excess income tax benefits from stock-based compensation plans	2,460	3,247
Repurchase of shares to satisfy employee tax withholdings	(8,052)	(8,245)
Proceeds from issuance of common stock	7,996	17,910
Net cash used in financing activities	(39,147)	(44,735)
Net increase (decrease) in cash and cash equivalents	(36,480)	7,160
Cash and cash equivalents at beginning of period	235,875	353,121
Cash and cash equivalents at end of period	\$ 199,395	\$ 360,281



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See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****ARRIS GROUP, INC.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****Note 1. Organization and Basis of Presentation**

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

The condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for a fair presentation of the consolidated financial statements for the periods shown. Interim results of operations are not necessarily indicative of results to be expected from a twelve-month period. These financial statements should be read in conjunction with the Company's most recently audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the United States Securities and Exchange Commission (SEC).

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

In December 2011, the Financial Accounting Standards Board (FASB) issued new disclosure requirements that are intended to enhance current disclosures on offsetting financial assets and liabilities. The new disclosures require an entity to disclose both gross and net information about financial instruments eligible for offset on the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. This new guidance is effective for the Company beginning January 1, 2013. The Company's accounting policy is to not offset amounts in its financial statements, and therefore, the adoption of this guidance will not have any impact on its consolidated financial statements.

**Note 3. Investments**

ARRIS investments as of June 30, 2012 and December 31, 2011 consisted of the following (in thousands):

	As of June 30, 2012	As of December 31, 2011
<b>Current Assets:</b>		
Available-for-sale securities	\$ 340,166	\$ 282,904
<b>Noncurrent Assets:</b>		
Available-for-sale securities	67,354	70,095
Cost method investments	3,613	1,000
	70,967	71,095
<b>Total</b>	<b>\$ 411,133</b>	<b>\$ 353,999</b>

ARRIS investments in debt and marketable equity securities are categorized as available-for-sale. The Company currently does not hold any held-to-maturity securities. Realized gains and losses on trading securities and available-for-sale securities are included in net income. Unrealized gains and losses on available-for-sale securities are included in our consolidated balance sheet as a component of accumulated other

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comprehensive income (loss). The total (gains) losses included in the accumulated other comprehensive income related to available-for-sale securities were (\$0.2) million and \$0.3 million, net of tax, as of June 30, 2012 and December 31,

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2011, respectively. Realized and unrealized gains and losses in total and by individual investment as of June 30, 2012 and December 31, 2011 were not material. The amortized cost basis of the Company's investments approximates fair value.

As of December 31, 2011, ARRIS' cost method investment is an investment in a private company. During the second quarter of 2012, ARRIS invested a total of \$3.0 million in two additional private companies. Due to the fact the investments are in a private companies, ARRIS is exempt from estimating the fair values. However, ARRIS is required to estimate the fair value if there has been an identifiable event or change in circumstance that may have a significant adverse effect on the fair value of the investment. Each quarter, ARRIS evaluates its investments for any other-than-temporary impairments, by reviewing any capital transactions, the current revenues, bookings and long-term plan of the private companies. During the evaluation performed as of December 31, 2011, ARRIS concluded that the private company would be depleting cash balances in early 2012. Further, ARRIS was notified that the private company intends to raise capital by offering a new round of financing to its existing and new investors. During the fourth quarter of 2011, ARRIS concluded that the investee's need to raise additional funds was an indicator of impairment and therefore, performed steps to determine the fair value of its investment in the private company. ARRIS was unable to apply traditional valuation techniques as the required inputs to these techniques are unavailable. ARRIS determined that the best estimate of the fair value of its investment was to calculate it based upon the preliminary indication of value related to the new round of financing. As a result of these considerations, ARRIS recorded an other-than-temporary impairment on its investment of \$3.0 million in the fourth quarter of 2011. During the second quarter of 2012, the private company continued its efforts to raise capital, and as part of this process, a new valuation was performed. The results indicated a further reduction in the valuation of the company. As a result, ARRIS concluded that its investment was further impaired and recorded an incremental other-than-temporary impairment of \$0.5 million in the second quarter of 2012. As of June 30, 2012, the balance of this investment is \$0.6 million, and the balance of the two new investments is their original cost of \$3.0 million.

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

### Note 4. Fair Value Measurement

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance establishes a fair value hierarchy that is based on the extent and level of judgment used to estimate the fair value of assets and liabilities. 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. An asset or liability's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the measurement of its fair value. The three levels of input defined by the authoritative guidance are as follows:

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

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

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

The following table presents the Company's investment assets and foreign currency contract positions measured at fair value on a recurring basis as of June 30, 2012 (in thousands):

	Level 1	Level 2	Level 3	Total
Current investments	\$ 127,589	\$ 212,577	\$	\$ 340,166
Noncurrent investments	11,926	55,428		67,354
Foreign currency contracts - asset position	1,601			1,601
Foreign currency contracts - liability position	573			573

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In addition to the amounts disclosed in the above table, the fair value of the Company's Israeli severance pay assets, which were almost fully comprised of Level 2 assets, was \$3.5 million and \$3.7 million as of June 30, 2012 and December 31, 2011, respectively.

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, government agency bonds, municipal 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.

In determining the value of certain Level 2 instruments, ARRIS has performed steps to verify the accuracy of the valuations provided by ARRIS brokerage firms. ARRIS has reviewed the most recent Statement on Standards for Attestation Engagements No. 16 (SSAE report) for each brokerage firm holding investments for ARRIS. The SSAE report for each did not identify any control weakness in the brokerages' policies and procedures, in particular as they relate to the pricing and valuation of financial instruments. ARRIS has determined the third party pricing source used by each firm to be a reliable recognized source of financial valuations. In addition ARRIS has performed further testing on a large sample of its corporate obligations and commercial paper investments. These tests did not show any material discrepancies in the valuations provided by the brokerage firms. It is the Company's intent to continue to verify valuations on a quarterly basis, using one or more reliable recognized third party pricing providers. See Note 3 and Note 5 for further information on the Company's investments and derivative instruments.

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

**Note 5. Derivative Instruments and Hedging Activities**

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

The fair values of ARRIS' derivative instruments recorded in the Consolidated Balance Sheet as of June 30, 2012 and December 31, 2011 were as follows (in thousands):

	As of June 30, 2012		As of December 31, 2011	
	<u>Balance Sheet Location</u>	<u>Fair Value</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
<i>Derivatives Not Designated as Hedging Instruments:</i>				
Foreign exchange contracts asset derivatives	Other current assets	\$ 1,601	Other current assets	\$ 3,295
Foreign exchange contracts liability derivatives	Other accrued liabilities	\$ 573	Other accrued liabilities	\$ 546

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The change in the fair values of ARRIS' derivative instruments recorded in the Consolidated Statements of Operations during the three and six months ended June 30, 2012 and 2011 were as follows (in thousands):

		Three Months Ended June 30,		Six Months Ended June 30,	
	<u>Statement of Operations Location</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Derivatives Not Designated as Hedging Instruments:					
Foreign exchange contracts	Loss (gain) on foreign currency	\$ (708)	\$ 881	\$ 77	\$ 3,014
<b>Note 6. Pension Benefits</b>					

**Note 6. Pension Benefits**

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Service cost	\$ 84	\$ 77	\$ 167	\$ 156
Interest cost	521	536	1,042	1,071
Expected gain on plan assets	(315)	(406)	(629)	(812)
Amortization of net loss	210	72	420	144
<b>Net periodic pension cost</b>	<b>\$ 500</b>	<b>\$ 279</b>	<b>\$ 1,000</b>	<b>\$ 559</b>

*Employer Contributions*

No minimum funding contributions are required in 2012 under the Company's defined benefit plan. However, the Company made voluntary contributions to the plan of approximately \$23 thousand and \$44 thousand for the three and six months ended June 30, 2012. Additionally, the Company made a voluntary contribution to the plan of \$0.5 million during the three months ended June 30, 2012. 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 June 30, 2012 was approximately \$16.3 million and is included in Investments on the Consolidated Balance Sheets.

**Note 7. Guarantees***Warranty*

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

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

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Information regarding the changes in ARRIS aggregate product warranty liabilities for the six months ended June 30, 2012 was as follows (in thousands):

Balance at December 31, 2011	\$ 6,387
Accruals related to warranties (including changes in estimates)	1,339
Settlements made (in cash or in kind)	(1,636)
Balance at June 30, 2012	\$ 6,090

**Note 8. Restructuring Charges**

ARRIS has restructuring accruals representing contractual obligations that related to excess leased facilities and equipment in ARRIS ATS segment. Payments will be made over their remaining lease terms through 2014, unless terminated earlier (in thousands):

Balance as of December 31, 2011	\$ 1,144
Payments	(191)
Balance as of June 30, 2012	\$ 953

In the fourth quarter of 2011, the Company initiated a restructuring plan as a result of its acquisition of BigBand Networks. The plan focuses on the rationalization of personnel, facilities and systems across multiple segments in the ARRIS organization. During the fourth quarter of 2011, ARRIS recorded a restructuring charge of \$3.4 million, of which \$3.3 million was related to severance and termination benefits and \$0.1 million was related to facilities. During the six months ended June 30, 2012, ARRIS recorded an additional restructuring charge of \$6.2 million, of which \$5.3 million was related to severance and termination benefits and \$0.9 million was related to facilities. As of June 30, 2012, the total liability remaining for this restructuring plan was approximately \$0.9 million, of which the severance component of \$0.2 million is expected to be paid in the third quarter of 2012 and the facility component of \$0.7 million will be paid over the remaining lease terms through 2016, unless terminated earlier (in thousands):

Balance as of December 31, 2011	\$ 3,052
Restructuring charges	6,242
Payments	(8,387)
Balance as June 30, 2012	\$ 907

**Note 9. Inventories**

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

	June 30, 2012	December 31, 2011
Raw material	\$ 21,717	\$ 22,759
Work in process	3,333	3,551
Finished goods	77,311	89,602

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Total inventories, net	\$ 102,361	\$ 115,912
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Property, plant and equipment, at cost, consisted of the following (in thousands):

	June 30, 2012	December 31, 2011
Land	\$ 2,562	\$ 2,612
Building and leasehold improvements	25,041	25,243
Machinery and equipment	170,784	163,851
	198,387	191,706
Less: Accumulated depreciation	(142,212)	(130,331)
Total property, plant and equipment, net	\$ 56,175	\$ 61,375

**Note 11. Convertible Senior Notes**

In 2006, the Company issued \$276.0 million of 2% convertible senior notes due 2026. The notes are convertible, at the option of the holder, based on an initial conversion rate, subject to adjustment, of 62.1504 shares per \$1,000 principal amount (which represents an initial conversion price of approximately \$16.09 per share of our common stock), into cash up to the principal amount and, if applicable, shares of the Company's common stock, cash or a combination thereof. The notes are unsecured senior obligations, and are effectively subordinated to all liabilities, including trade payables and lease obligations of the Company's subsidiaries. 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 August 3, 2012, 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 2011, the Company acquired \$5.0 million face value of the notes for approximately \$5.0 million. The Company allocated \$2 thousand to the reacquisition of the equity component of the notes. The Company also wrote off approximately \$33 thousand of deferred finance fees associated with the portion of the notes acquired. As a result, the Company realized a loss of approximately \$19 thousand on the retirement of the notes.

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

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

	June 30, 2012	December 31, 2011
Carrying amount of the equity component	\$ 48,209	\$ 48,209

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Principal amount of the liability component	\$ 232,050	\$ 232,050
Unamortized discount	(16,227)	(22,284)
Net carrying amount of the liability component	\$ 215,823	\$ 209,766

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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 six months ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Contractual interest recognized	\$ 1,160	\$ 1,185	\$ 2,321	\$ 2,371
Amortization of discount	3,058	2,888	6,057	5,720

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 June 30, 2012 and December 31, 2011 was \$0.9 million and \$1.2 million, respectively.

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

**Note 12. 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 ( CODM ) for evaluating segment performance and deciding how to allocate resources to segments. The Company's chief executive officer has been identified as the CODM.

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

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

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

These operating segments were determined based on the nature of the products and services offered.

The Company evaluates performance based on several factors, of which the primary financial measures are revenues and gross margins. A measure of assets is not applicable, as segment assets are not regularly reviewed by the CODM for evaluating performance and allocating resources to the segment. The accounting policies of the operating segments are the same as those disclosed in Form 10-K for the year ended December 31, 2011.

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The table below represents information about the Company's reporting segments for the three and six months ended June 30, 2012 and 2011 (in thousands):

	For the Three Months		For the Six Months	
	<u>Ended June 30,</u>		<u>Ended June 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
<b>Business Segment:</b>				
<b>BCS:</b>				
Sales	\$ 280,592	\$ 201,844	\$ 525,107	\$ 408,474
Gross Margin	96,362	85,812	185,927	162,869
<b>ATS:</b>				
Sales	52,225	46,870	96,281	92,492
Gross Margin	10,965	11,332	21,600	22,316
<b>MCS:</b>				
Sales	16,510	17,085	30,839	32,269
Gross Margin	11,199	9,754	19,907	18,659
<b>Total :</b>				
Sales	\$ 349,327	\$ 265,799	\$ 652,227	\$ 533,235
Gross Margin	\$ 118,526	\$ 106,898	\$ 227,434	\$ 203,844

### Note 13. 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 six months ended June 30, 2012 and 2011 are set forth below (in thousands):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Comcast and affiliates	\$ 96,189	\$ 67,314	\$ 177,991	\$ 140,247
% of sales	27.5%	25.3%	27.3%	26.3%
Time Warner Cable and affiliates	\$ 75,317	\$ 33,266	\$ 122,421	\$ 80,877
% of sales	21.6%	12.5%	18.8%	15.2%

ARRIS sells its products primarily in the United States. The Company's international revenue is generated from Asia Pacific, Canada, Europe, and Latin America. The Asia Pacific market primarily includes China, Hong Kong, Japan, Korea, Singapore, and Taiwan. The European market primarily includes Austria, Belgium, France, Germany, Great Britain, Hungary, Ireland, Israel, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Spain, Sweden, Switzerland, and Turkey. The Latin American market primarily includes Argentina, Bahamas, Brazil, Chile, Colombia, Costa Rica, Ecuador, Honduras, Jamaica, Mexico, Panama, Peru, and Puerto Rico. For the three months ended June 30, 2012 and 2011, sales to international customers were approximately 26.2% and 31.7%, respectively, of total sales. For the six months ended June 30, 2012 and 2011, sales to international customers were 25.6% and 30.4%, respectively, of total sales.

International sales by region for the three and six months ended June 30, 2012 and 2011 were as follows (in thousands):

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	<b><u>Three Months Ended</u></b>		<b><u>Six Months Ended</u></b>	
	<b><u>June 30,</u></b>		<b><u>June 30,</u></b>	
	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Americas, excluding U.S. <sup>(1)</sup>	\$ 55,923	\$ 47,477	\$ 103,827	\$ 87,099
Asia Pacific	14,289	11,150	24,748	26,062
EMEA	21,361	25,704	38,375	48,741
Total international sales	\$ 91,573	\$ 84,331	\$ 166,950	\$ 161,902

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- (1) Excludes U.S. sales of \$257.7 million and \$485.2 million for the three and six months ended June 30, 2012, respectively. Excludes U.S. sales of \$181.5 million and \$371.3 million for the three and six months ended June 30, 2011, respectively.

### Note 14. 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		Six Months Ended	
	June 30,		June 30,	
	2012 <sup>(1)</sup>	2011 <sup>(1)</sup>	2012 <sup>(1)</sup>	2011 <sup>(1)</sup>
<b>Basic:</b>				
Net income	\$ 15,001	\$ 16,690	\$ 20,800	\$ 28,254
Weighted average shares outstanding	113,842	121,800	114,457	122,047
Basic earnings per share	\$ 0.13	\$ 0.14	\$ 0.18	\$ 0.23
<b>Diluted:</b>				
Net income	\$ 15,001	\$ 16,690	\$ 20,800	\$ 28,254
Weighted average shares outstanding	113,842	121,800	114,457	122,047
Net effect of dilutive equity awards	1,269	1,911	1,895	2,673
Total	115,111	123,711	116,352	124,720
Diluted earnings per share	\$ 0.13	\$ 0.13	\$ 0.18	\$ 0.23

- (1) EPS may not recalculate directly due to rounding.

The Company has \$232.1 million of convertible senior notes outstanding at June 30, 2012. Upon conversion, ARRIS will satisfy at least the principal amount in cash, rather than common stock. This reduced the potential earnings dilution to only include the conversion premium, which is the difference between the conversion price per share of common stock and the average share price. The average share price during the six months ended June 30, 2012 and 2011 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 4.2 million shares and 3.3 million shares for the three and six months ended June 30, 2012, respectively. During the same periods in 2011, approximately 5.5 million shares and 3.8 million shares, respectively, were excluded from the dilutive securities above. These exclusions are made if the exercise price of these options is greater than the average market price of the common stock for the period, or if the Company has net losses, both of which have an anti-dilutive effect.

During the six months ended June 30, 2012, the Company issued 2.4 million shares of its common stock related to stock option exercises and the vesting of restricted shares, as compared to 4.0 million shares for the twelve months ended December 31, 2011.

**Table of Contents****Note 15. Income Taxes**

In the first half of 2012 and 2011, the Company recorded income tax expense of \$10.4 million and \$5.9 million, respectively. Below is a summary of the components of the tax expense for the three and six month periods ended June 30, 2012 and 2011 (in thousands, except for percentages):

	For the Three Months Ended June 30,						For the Six Months Ended June 30,					
	2012			2011			2012			2011		
	Income Before Tax	Income Tax Expense	Effective Tax Rate	Income Before Tax	Income Tax Expense	Effective Tax Rate	Income Before Tax	Income Tax Expense	Effective Tax Rate	Income Before Tax	Income Tax Expense	Effective Tax Rate
Non-discrete Items	\$ 22,562	\$ 7,561	33.5%	\$ 22,837	\$ 6,147	26.9%	\$ 31,248	\$ 10,448	33.4%	\$ 34,162	\$ 9,490	27.7%
Discrete tax events valuation allowances, uncertain tax positions											(3,582)	
Total	\$ 22,562	\$ 7,561	33.5%	\$ 22,837	\$ 6,147	26.9%	\$ 31,248	\$ 10,448	33.4%	\$ 34,162	\$ 5,908	17.2%

During the first half of 2012, as compared to the same period in 2011, the Company did not record any benefits attributable to research and development tax credits and will not be able to record such benefits until legislation permitting such credits is signed into law.

During the first quarter of 2011, the Company identified \$4.0 million of discrete tax benefits relating to the release of valuation allowances against state deferred tax assets, which was partially offset by \$0.4 million of additional liabilities related to uncertain tax positions attributable to AMT credits.

**Note 16. Repurchases of ARRIS Common Stock**

The table below sets forth the purchases of ARRIS common stock for the quarter ended June 30, 2012:

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
				(in thousands)
April 2012	1,358,971	\$ 11.21	1,358,971	\$ 30,000
May 2012	952	\$ 11.54	-	\$ 30,000
June 2012	-	-	-	\$ 30,000

(1) Includes approximately 952 shares repurchased to satisfy tax withholding obligations that arose on the vesting of shares of restricted stock and restricted stock units.

In March 2009, the Company announced that its Board of Directors had authorized a plan for ARRIS to repurchase up to \$100 million of our common stock. The Company did not repurchase any shares under the plan during 2009. During the fiscal year 2010, ARRIS repurchased and retired approximately 6.8 million shares of its common stock at an average price of \$10.24 per share for an aggregate purchase price of \$69.3

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million. In May 2011, the share repurchase authorization amount under the 2009 plan was exhausted.

In May 2011, the Company's Board of Directors authorized a new plan for the Company to purchase up to \$150 million of the Company's common stock. During the fiscal year 2011, ARRIS repurchased and retired approximately 10.0 million shares of its common stock at an average price of \$10.95 per share for an aggregate consideration of approximately \$109.1 million.

During the first three months of 2012, ARRIS repurchased 2.3 million shares of the Company's common stock at an average price of \$11.32 per share, for an aggregate consideration of approximately \$26.3 million. During the second quarter of 2012, ARRIS repurchased 1.4 million shares of the Company's common stock at an average price of \$11.21 per share, for an aggregate consideration of approximately \$15.2 million.



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Unless terminated earlier by a Board resolution, the Program will expire when we have used all authorized funds for repurchase. The remaining authorized amount for stock repurchases under this program was \$30.0 million as of June 30, 2012.

### **Note 17. Contingencies**

The Company accrues a liability for legal contingencies when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The Company reviews these accruals and adjusts them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and the Company's views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in the Company's accrued liabilities would be recorded in the period in which such determinations are made. Unless noted otherwise, the amount of liability is not probable or the amount cannot be reasonably estimated; and, therefore, accruals have not been made.

Due to the nature of the Company's business, it is subject to patent infringement claims, including current suits against it or one or more of its wholly-owned subsidiaries, or one or more of our customers who may seek indemnification from us, alleging infringement by various Company products and services. The Company believes that it has meritorious defenses to the allegation made in its pending cases and intends to vigorously defend these lawsuits; however, it is currently unable to determine the ultimate outcome of these or similar matters. In addition, the Company is a defendant in various litigation matters generally arising out of the normal course of business.

See Part II, Item 1, Legal Proceedings for further information.

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

#### **Overview**

We are a global communications technology company, headquartered in Suwanee, Georgia. We operate in three business segments, Broadband Communications Systems (BCS), Access, Transport & Supplies (ATS), and Media & Communications Systems (MCS). A detailed description of each segment is contained in Our Principal Products in our Form 10-K for the year ended December 31, 2011. We specialize in integrated broadband network solutions that include products, systems and software for content and operations management (including video on demand, or VOD), and professional services. We are a leading developer, manufacturer and supplier of telephony, data, video, construction, rebuild and maintenance equipment for the broadband communications industry. In addition, we are a leading supplier of infrastructure products used by cable system operators to build-out and maintain hybrid fiber-coaxial (HFC) networks. We provide our customers with products and services that enable reliable, high speed, two-way broadband transmission of video, telephony, and data.

#### **Our Strategy and Key Highlights**

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

- Maintain a strong capital structure, mindful of our 2013 debt maturity, 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 delivery, multi-screen video, operations management, network integration, and business services opportunities.

Below are some key highlights relative to the second quarter and first half of 2012:

#### **Financial Highlights**

Sales in the second quarter and first half of 2012 were \$349.3 million and \$652.2 million, respectively, as compared to \$265.8 million and \$533.2 million in the same periods in 2011. The increase is primarily attributed to high demand for our DOCSIS 3.0 CPE products, the introduction of our Video Gateway products in Q3 2011, as well as the inclusion of sales of our EMP product resulting from our late 2011 acquisition of BigBand Networks.

Gross margin percentage was 33.9% in the second quarter of 2012, which compares to 40.2% in the second quarter of 2011 and 36.0% in the first quarter of 2012. The year over year decline reflects a change in product mix including higher sales of DOCSIS 3.0 CPE and Video Gateway products (which have lower than average margins) and lower CMTS software sales (which have higher than average margins.)

Total operating expenses (excluding amortization of intangible assets) in the second quarter of 2012 were \$84.2 million, as compared to \$72.5 million in the same period last year. The increase is the result of the inclusion of expenses associated with BigBand.

We ended the second quarter 2012 with an order backlog of approximately \$251.9 million and a book-to-bill ratio of 0.93. This compares to \$154.2 million and 0.91 in the second quarter 2011, respectively.

We ended the second quarter of 2012 with \$576.3 million of cash, cash equivalents, short-term and long-term marketable security investments. We generated approximately \$65.9 million and \$27.8 million of cash from operating activities in the first half of 2012 and 2011, respectively.

In the first half of 2012, we used \$41.6 million of cash to repurchase 3.7 million shares of our common stock.



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### *Product Line Highlights*

#### Broadband Communications Systems

- o CMTS
  - i Shift in product mix resulted in a higher mix of new hardware (both downstream and upstream line cards) and lower downstream software licenses in 2Q12
  - i Total downstream channels shipped were strong but below peak levels seen the last several quarters.
  - i Upstream shipments increased as the new cost-reduced 24U line card began deployment in earnest, increasing the density of existing C4 CMTS footprint as well as being included in new chassis shipments.
  - i Continued progress on development and early customer testing of next generation Converged Edge Router CMTS product that will enable smooth transition of legacy video networks to IP.
- o Video Processing
  - i New programmable VIPr Video Processing platform deployed for advanced videoing grooming and Ad Splicing. Platform also under test by several operators for additional applications such as Network DVR video grooming and MPEG4 Transcoding.
- o Whole House Solution
  - i Deployments continue with announced customers; expecting several additional commercial deployments to start in the third quarter 2012 with smaller operators.
  - i New projects launched that include integration of third party middleware software providers in close collaboration with lead customers.
- o CPE
  - i Total CPE unit shipments up 22% vs. previous quarter to 2.0 million units, as demand for advanced DOCSIS3.0 devices increase across a broad set of customers.
  - i Mix of DOCSIS 3.0 CPE increased to 82% of the total unit shipments as compared to 61 % in the previous quarter.
  - i Maintained number one EMTA market share for 30 consecutive quarters. (source: Infonetics)
  - i Strong demand for DOCSIS 3.0 WiFi Voice and Data Gateway variants driving overall ASP increase for this product category.
- o Edge Media Processing
  - i Solid shipments of new MSP-QAM platform during the quarter
  - i Expansion of SDV platform with several Tier 1 U.S. MSOs.

#### Access, Transport & Supplies

- o Improved sales momentum vs. previous quarter as node split activity continues and shipments of Metro Wi-Fi products increased during the quarter.

#### Media & Communications Systems

- o Added new customers in North America and CALA region for our ServAssure™ product
- o Added new CALA customers for our Advertising and VOD Solutions
- o Announced several 3rd party integration efforts aimed at improving operations performance (Skycreek) and TV Multiscreen Video distribution (Azuki, SeaWell Networks).

### **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 six months ended June 30, 2012 and 2011 which detail and reconcile GAAP and non-GAAP earnings per share:



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(in thousands, except per share data)

For the Three Months Ended June 30, 2012

	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Net income in accordance with GAAP	\$ 118,526	\$ 91,601	\$ 26,925	\$ 4,363	\$ 7,561	\$ 15,001
Purchase accounting impacts of deferred revenue	663	-	663	-	-	663
Stock compensation expense	809	(7,058)	7,867	-	-	7,867
Amortization of intangible assets	-	(7,444)	7,444	-	-	7,444
Acquisition costs	-	(102)	102	-	-	102
Restructuring	-	(1,039)	1,039	-	-	1,039
Impairment of investment	-	(466)	466	-	-	466
Non-cash interest expense	-	-	-	(3,058)	-	3,058
Tax related to items above	-	-	-	-	6,749	(6,749)
Non-GAAP net income	\$ 119,998	\$ 75,492	\$ 44,506	\$ 1,305	\$ 14,310	\$ 28,891
GAAP net income per share - diluted						\$ 0.13
Non-GAAP net income per share - diluted						\$ 0.25
Weighted average common shares - diluted						115,111

(in thousands, except per share data)

For the Six Months Ended June 30, 2012

	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Net income in accordance with GAAP	\$ 227,434	\$ 188,817	\$ 38,617	\$ 7,369	\$ 10,448	\$ 20,800
Purchase accounting impacts of deferred revenue	1,921	-	1,921	-	-	1,921
Stock compensation expense	1,559	(12,957)	14,516	-	-	14,516
Amortization of intangible assets	-	(14,823)	14,823	-	-	14,823
Acquisition costs	-	(709)	709	-	-	709
Restructuring	-	(6,242)	6,242	-	-	6,242
Loss of sale of product line	-	(337)	337	-	-	337
Impairment of investment	-	(466)	466	-	-	466
Non-cash interest expense	-	-	-	(6,057)	-	6,057
Tax related to items above	-	-	-	-	14,870	(14,870)
Non-GAAP net income	\$ 230,914	\$ 153,283	\$ 77,631	\$ 1,312	\$ 25,318	\$ 51,001
GAAP net income per share - diluted						\$ 0.18
Non-GAAP net income per share - diluted						\$ 0.44
Weighted average common shares - diluted						116,352

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(in thousands, except per share data)

**For the Three Months Ended June 30, 2011**

	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Net income in accordance with GAAP	\$ 106,898	\$ 81,441	\$ 25,457	\$ 2,620	\$ 6,147	\$ 16,690
Stock compensation expense	557	(5,368)	5,925	-	-	5,925
Amortization of intangible assets	-	(8,944)	8,944	-	-	8,944
Non-cash interest expense	-	-	-	(2,889)	-	2,889
Tax related to items above	-	-	-	-	4,915	(4,915)
Non-GAAP net income	\$ 107,455	\$ 67,129	\$ 40,326	\$ (269)	\$ 11,062	\$ 29,533
GAAP net income per share - diluted						\$ 0.13
Non-GAAP net income per share - diluted						\$ 0.24
Weighted average common shares - diluted						123,711

(in thousands, except per share data)

**For the Six Months Ended June 30, 2011**

	<u>Gross Margin</u>	<u>Operating Expense</u>	<u>Operating Income</u>	<u>Other (Income) Expense</u>	<u>Income Tax Expense (Benefit)</u>	<u>Net Income (Loss)</u>
Net income in accordance with GAAP	\$ 203,844	\$ 163,263	\$ 40,581	\$ 6,419	\$ 5,908	\$ 28,254
Stock compensation expense	994	(10,215)	11,209	-	-	11,209
Amortization of intangible assets	-	(17,888)	17,888	-	-	17,888
Non-cash interest expense	-	-	-	(5,721)	-	5,721
Tax related to items above	-	-	-	-	9,939	(9,939)
Adjustments of income tax valuation allowances, R&D credits, and other discrete tax items	-	-	-	-	3,583	(3,583)
Non-GAAP net income	\$ 204,838	\$ 135,160	\$ 69,678	\$ 698	\$ 19,430	\$ 49,550
GAAP net income per share - diluted						\$ 0.23
Non-GAAP net income per share - diluted						\$ 0.40
Weighted average common shares - diluted						124,720

In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items is useful in understanding the trends and managing our operations. We provide these supplemental non-GAAP measures in order to assist the investment community to see ARRIS through the eyes of management, and therefore enhance understanding of ARRIS operating performance. Non-GAAP financial measures should be viewed in addition to, and not as an alternative to, the Company's reported results prepared in accordance with GAAP. Our non-GAAP financial measures reflect adjustments based on the following items, as well as the related income tax effects:

Purchase Accounting Impacts Related to Deferred Revenue: In connection with our acquisition of BigBand, business combination rules require us to account for the fair values of deferred revenue arrangements for which acceptance has not been obtained, and post contract support in our

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purchase accounting. The non-GAAP adjustment to our sales and cost of sales is intended to include the full amounts of such revenues as if these purchase accounting adjustments had not been applied. We believe the adjustment to these revenues is useful as a measure of the ongoing performance of our business. We have historically experienced high renewal rates related to our support agreements and our objective is to increase the renewal rates on acquired post contract support agreements; however, we cannot be certain that our customers will renew our contracts.

Stock-Based Compensation Expense: We have excluded the effect of stock-based compensation expenses in calculating our non-GAAP operating expenses and net income (loss) measures. Although stock-based compensation is a key incentive offered to our employees, we continue to evaluate our business performance excluding stock-based compensation expenses. We record non-cash compensation expense related to grants of options and restricted stock. Depending upon the size, timing and the terms of the grants, the non-cash compensation expense may vary significantly but will recur in future periods.

Amortization of Intangible Assets: We have excluded the effect of amortization of intangible assets in calculating our non-GAAP operating expenses and net income (loss) measures. Amortization of intangible assets is non-cash, and is inconsistent in amount and frequency and is significantly affected by the timing and size of our



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acquisitions. Investors should note that the use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

**Acquisition Costs:** We have excluded the effect of acquisition related expenses in calculating our non-GAAP operating expenses and net income (loss) measures. We incurred significant expenses in connection with our recent acquisition of BigBand, which we generally would not have otherwise incurred in the periods presented as part of our continuing operations. Acquisition related expenses consist of transaction costs, costs for transitional employees, other acquired employee related costs, and integration related outside services. We believe it is useful to understand the effects of these items on our total operating expenses.

**Restructuring Costs:** We have excluded the effect of restructuring charges in calculating our non-GAAP operating expenses and net income (loss) measures. Restructuring expenses consist of employee severance, abandoned facilities, and other exit costs. We believe it is useful to understand the effects of these items on our total operating expenses.

**Loss on Sale of Product Line:** We have excluded the effect of a loss on the sale of a product line in calculating our non-GAAP operating expenses and net income measures. We believe it is useful to understand the effects of these items on our total operating expenses.

**Non-Cash Interest on Convertible Debt:** We have excluded the effect of non-cash interest in calculating our non-GAAP operating expenses and net income (loss) measures. We record the accretion of the debt discount related to the equity component non-cash interest expense. We believe it is useful to understand the component of interest expense that will not be paid out in cash.

**Impairment of Investment:** We have excluded the effect of an other-than-temporary impairment of a cost method investment in calculating our non-GAAP financial measures. We believe it is useful to understand the effect of this non-cash item in our other expense (income).

**Income Tax Expense (Benefit):** We have excluded the tax effect of the non-GAAP items mentioned above. Additionally, we have excluded the effects of certain tax adjustments related to state valuation allowances, research and development tax credits and provision to return differences.

## Significant Customers

The Company's two largest customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. Over the past year, certain customers' beneficial ownership may have changed as a result of mergers and acquisitions. Therefore the revenue for ARRIS' customers for prior periods has been adjusted to include the affiliates under common control. A summary of sales to these customers for the three and six months ended June 30, 2012 and 2011 are set forth below (in thousands):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Comcast and affiliates	\$ 96,189	\$ 67,314	\$ 177,991	\$ 140,247
% of sales	27.5%	25.3%	27.3%	26.3%
Time Warner Cable and affiliates	\$ 75,317	\$ 33,266	\$ 122,421	\$ 80,877
% of sales	21.6%	12.5%	18.8%	15.2%

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### Comparison of Operations for the Three and Six Months Ended June 30, 2012 and 2011

#### Net Sales

The table below sets forth our net sales for the three and six months ended June 30, 2012 and 2011, for each of our segments (in thousands):

	Net Sales				Increase (Decrease) Between 2012 and 2011			
	For the Three Months Ended		For the Six Months Ended		For the Three Months Ended		For the Six Months Ended	
	<u>June 30,</u>		<u>June 30,</u>		<u>June 30</u>		<u>June 30</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
<i>Business Segment:</i>								
BCS	\$ 280,592	\$ 201,844	\$ 525,107	\$ 408,474	\$ 78,748	39.0%	\$ 116,633	28.6%
ATS	52,225	46,870	96,281	92,492	5,355	11.4%	3,789	4.1%
MCS	16,510	17,085	30,839	32,269	(575)	(3.4)%	(1,430)	(4.4)%
Total sales	\$ 349,327	\$ 265,799	\$ 652,227	\$ 533,235	\$ 83,528	31.4%	\$ 118,992	22.3%

The table below sets forth our domestic and international sales for the three and six months ended June 30, 2012 and 2011 (in thousands):

	Net Sales				Increase (Decrease) Between 2012 and 2011			
	For the Three Months Ended		For the Six Months Ended		For the Three Months Ended		For the Six Months Ended	
	<u>June 30,</u>		<u>June 30,</u>		<u>June 30</u>		<u>June 30</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Domestic	\$ 257,754	\$ 181,468	\$ 485,278	\$ 371,333	\$ 76,286	42.0%	\$ 113,945	30.7%
International	91,573	84,331	166,949	161,902	7,242	8.6%	5,047	3.1%
Total sales	\$ 349,327	\$ 265,799	\$ 652,227	\$ 533,235	\$ 83,528	31.4%	\$ 118,992	22.3%

#### Broadband Communication Systems Net Sales 2012 vs. 2011

During the three and six months ended June 30 2012, sales in our BCS segment increased by approximately 39.0% and 28.6%, respectively, as compared to the same period in 2011. The increase is primarily attributable to high demand for our DOCSIS3.0 CPE equipment, the sale of Video Gateway products introduced in Q3 2011, as well as the inclusion of sales associated with our late Q4 2011 acquisition of BigBand.

#### Access, Transport & Supplies Net Sales 2012 vs. 2011

During the three and six months ended June 30, 2012, sales in our Access, Transport and Supplies segment increased by approximately 11.4% and 4.1%, respectively, as compared to the same period in 2011. The increase in sales is primarily the result of higher demand for both headend optics and radio frequency amplifiers, as well as the sale of metro Wi-Fi wireless products.

#### Media & Communication Systems Net Sales 2012 vs. 2011

During the three and six months ended June 30, 2012, sales in our Media & Communications Systems segment decreased by approximately 3.4% and 4.4%, respectively, as compared to the same period in 2011. Revenue in this segment varies as it is tied to customer acceptances and non-linear orders.

#### Gross Margin

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The table below sets forth our gross margin for the three and six months ended June 30, 2012 and 2011, for each of our reporting segments (in thousands):

	Gross Margin \$				Increase (Decrease) Between 2012 and 2011			
	For the Three Months Ended		For the Six Months Ended		For the Three Months Ended		For the Six Months Ended	
	<u>June 30,</u>		<u>June 30,</u>		<u>June 30</u>		<u>June 30</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
<i>Business Segment:</i>								
BCS	\$ 96,362	\$ 85,812	\$ 185,927	\$ 162,869	\$ 10,550	12.3%	\$ 23,058	14.2%
ATS	10,965	11,332	21,600	22,316	(367)	(3.2)%	(716)	(3.2)%
MCS	11,199	9,754	19,907	18,659	1,445	14.8%	1,248	6.7%
Total	\$ 118,526	\$ 106,898	\$ 227,434	\$ 203,844	\$ 11,628	10.9%	\$ 23,590	11.6%

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The table below sets forth our gross margin percentages for the three and six months ended June 30, 2012 and 2011, for each of our business segments:

	Gross Margin %				Increase (Decrease) Between 2012 and 2011	
	For the Three Months Ended		For the Six Months Ended		For the Three Months Ended	For the Six Months Ended
	<u>June 30,</u>		<u>June 30,</u>		<u>June 30</u>	<u>June 30</u>
	2012	2011	2012	2011	Percentage Points	
<b>Business Segment:</b>						
BCS	34.3%	42.5%	35.4%	39.9%	(8.2)	(4.5)
ATS	21.0%	24.2%	22.4%	24.1%	(3.2)	(1.7)
MCS	67.8%	57.1%	64.6%	57.8%	10.7	6.8
Total	33.9%	40.2%	34.9%	38.2%	(6.3)	(3.3)

### Broadband Communications Systems Gross Margin 2012 vs. 2011

Broadband Communications Systems segment gross margin percentage decreased but gross margin dollars increased during the three and six months ended June 30, 2012 as compared to the same period in 2011. The decrease in gross margin percentage reflects a product mix change as we had higher CPE sales and proportionally lower CMTS revenue (CMTS products have a higher gross margin than CPE products). Further, we have lower CMTS software sales in the first two quarters of 2012 as compared to 2011, which have higher gross margin. The increase in gross margin dollar was primarily the result of higher sales.

### Access, Transport & Supplies Gross Margin 2012 vs. 2011

The Access, Transport & Supplies segment gross margin dollars and gross margin percentage decreased during the three and six months ended June 30, 2012 as compared to the same period in 2011. The decrease was driven by product mix, primarily resulting from lower gross margin for infrastructure related products.

### Media & Communications Systems Gross Margin 2012 vs. 2011

Media & Communications Systems segment gross margin dollars and gross margin percentage increased during the three and six months ended June 30, 2012. The increase in gross margin dollar and gross margin percentage was due to higher sales and product mix.

## Operating Expenses

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

	Operating Expenses				Increase (Decrease) Between 2012 and 2011			
	For the Three Months Ended		For the Six Months Ended		For the Three Months Ended	For the Six Months Ended		
	<u>June 30,</u>		<u>June 30,</u>		<u>June 30</u>	<u>June 30</u>		
	2012	2011	2012	2011	\$	%	\$	%
SG&A	\$ 40,135	\$ 35,868	\$ 79,678	\$ 72,706	\$ 4,267	11.9%	\$ 6,972	9.6%
Research & development	42,881	36,629	87,028	72,669	6,252	17.1%	14,359	19.8%
Restructuring charges	1,039		6,242		1,039	100%	6,242	100%
Acquisition costs	102		709		102	100%	709	100%
Loss on sale of product line			337				337	100%
Amortization of intangibles	7,444	8,944	14,823	17,888	(1,500)	(16.8)%	(3,065)	(17.1)%
Total	\$ 91,601	\$ 81,441	\$ 188,817	\$ 163,263	\$ 10,160	12.5%	\$ 25,554	15.7%

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

The year over year increase in SG&A expenses primarily reflects the addition of BigBand and higher legal expenses.



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### *Research & Development, or R&D, Expenses*

The year over year increase in R&D expenses reflects the addition of BigBand and increased headcount, as we continued to aggressively invest in R&D.

### *Restructuring Charges*

During the first half of 2012, ARRIS continued its implementation of the restructuring initiative following the acquisition of BigBand to align our workforce and operating costs with current business opportunities. This resulted in restructuring charges of \$1.0 million and \$6.2 million related to severance and facilities during the three month and six month ending June 30, 2012, respectively. For the three and six month periods ending June 30, 2011, we did not have any restructuring charges.

### *Acquisition Costs*

During the second quarter of 2012, we recorded acquisition related expenses of \$0.1 million. For the six month period ending June 30, 2012, we recorded acquisition related expenses of \$0.7 million. These expenses were related to the acquisition of BigBand and consisted of transaction costs and integration related outside services.

### *Loss on Sale of Product Line*

In March of 2012, the Company completed the sale of certain assets of its ECCO electronic connector product line to Eclipse Embedded Technologies, Inc. for approximately \$3.9 million. The Company recorded a net loss of \$(0.3) million on the sale, which included approximately \$0.3 million of transaction related costs. The results of the ECCO product line were deemed immaterial to the overall financial results of the Company, and as such the Company has not reported the results in discontinued operations

### *Amortization of Intangibles*

Intangibles amortization expense for the three months ended June 30, 2012 and 2011 was \$7.4 million and \$8.9 million, respectively. For the six months ended June 30, 2012 and 2011, intangible amortization expense was \$14.8 million and \$17.9 million, respectively. Our intangible expense is related to the acquisitions of BigBand Networks in November 2011, Digeo, Inc. in October 2009, EG Technologies in September 2009, Auspice Corporation in August 2008 and C-COR Incorporated in December 2007.

### *Goodwill Impairment*

Goodwill relates to the excess of cost over the fair value of net assets resulting from an acquisition. Our goodwill is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. During the three and six months ended June 30, 2012 and 2011, no indicators of impairment existed and, therefore, no impairment charges were recorded.

Based on our most recent annual goodwill impairment assessment performed as of October 1, 2011, the Company determined that our BCS reporting unit was not at risk of failing step one of the goodwill impairment test. In performing step one of impairment testing, the Company determined that the fair values of the MCS reporting unit was less than its respective carrying value, as a result of a decline in the expected future cash flows for the reporting unit. In making our assessment regarding MCS future cash flows, a number of specific factors arose from our annual strategic planning process in the fourth quarter, including an assessment of historical operating results, key customer inputs, and anticipated development expenditures required to migrate the product portfolio in line with the changing market dynamics, including the evolution from a proprietary to open standards IP architecture. As a result of these factors, the Company has decided to shift some investment from the MCS reporting unit to its BCS reporting unit. Given the decision to reduce our investment going forward, we correspondingly moderated our long term projections for the MCS segment. The Company proceeded to step two of the goodwill impairment test to determine the implied fair value of the MCS goodwill. The Company concluded that the implied fair value of the goodwill was less than its carrying value, which resulted in a write off of all goodwill as of October 1, 2011 of \$41.2 million before tax (\$33.9 million after tax) for the MCS reporting unit. This expense was recorded in impairment of goodwill and intangibles line on the consolidated statements of operations.

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The fair value of our ATS reporting unit exceeded its carrying value by \$21.9 million, or 7.6%, and thus was at risk of failing step one of the goodwill impairment test, and was therefore at risk of a future impairment in the event of significant unfavorable changes in the forecasted cash flows or the key assumptions used in our analysis, including the weighted average cost of capital (discount rate) and growth rates utilized in the discounted cash flow analysis.

The following table sets forth the information regarding our ATS reporting unit as of October 1, 2011 (annual goodwill impairment testing date), including key assumptions (dollars in thousands):

	Key Assumptions		% Fair Value Exceeds Carrying Value as of October 1, 2011	Goodwill as of October 1, 2011	
	Discount Rate	Terminal Growth Rate	Percentage	Amount	Percent of Total Assets
ATS	14.0%	3.0%	7.6%	\$ 35,905	9.3%

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

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

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

- a prolonged decline in capital spending for constructing, rebuilding, maintaining, or upgrading broadband communications systems;
- rapid changes in technology occurring in the broadband communication markets which could lead to the entry of new competitors or increased competition from existing competitors that would adversely affect our sales and profitability;
- the concentration of business we receive from several key customers, the loss of which would have a material adverse effect on our business;
- continued consolidation of our customers base in the telecommunications industry could result in delays or reductions in purchases of our products and services, if the acquirer decided not to continue using us as a supplier;
- new products and markets currently under development may fail to realize anticipated benefits;
- changes in business strategies affecting future investments in businesses, products and technologies to complement or expand our business could result in adverse impacts to existing business and products;
- volatility in the capital (equity and debt) markets, resulting in a higher discount rate; and
- legal proceeding settlements and/or recoveries, and its affect on future cash flows.

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As a result, there can be no assurance that the estimates and assumptions made for purposes of the annual goodwill impairment test will prove to be accurate predictions of the future. Although management believes the assumptions and estimates made are reasonable and appropriate, different assumptions and estimates could materially impact the reported financial results. The table below provides sensitivity analysis related to the impact of each of the key assumptions, on a standalone basis, on the resulting percentage change in fair value of our ATS reporting unit as of October 1, 2011:

	Percentage Reduction in Fair Value (Income Approach)		
	Assuming Hypothetical 10% Reduction in cash flows	Assuming Hypothetical 1% increase in Discount Rate	Assuming Hypothetical 1% decrease in Terminal Growth Rate
ATS	-5.9%	-5.9%	-2.3%
<i>Other Expense (Income)</i>			

### *Interest Expense*

Interest expense for the three months ended June 30, 2012 and 2011 was \$4.4 million and \$4.2 million respectively. For the six months ended June 30, 2012 and 2011, interest expense was \$8.8 million and \$8.4 million respectively. Interest expense reflects the amortization of deferred finance fees, the non-cash interest component of our convertible subordinated notes, interest paid on the notes, capital leases and other debt obligations.

### *Interest Income*

Interest income during the three months ended June 30, 2012 and 2011 was \$0.7 million and \$0.9 million, respectively. During the six months ended June 30, 2012 and 2011, interest income was \$1.5 million and \$1.7 million, respectively. The income reflects interest earned on cash, cash equivalents, short-term and long-term investments.

### *Loss (Gain) on Foreign Currency*

During the three and six months ended June 30, 2012, we recorded a foreign currency loss of approximately \$0.5 million and \$1.3 million, respectively. During the three months and six months ended June 30, 2011, we recorded a foreign currency loss of approximately \$0.1 million and \$1.0 million, respectively. We have certain international customers who are billed in their local currency, primarily the euro. To mitigate the volatility related to fluctuations in the foreign exchange rates, we may enter into various foreign currency contracts. The loss (gain) on foreign currency is driven by the fluctuations in the foreign currency exchanges rates, primarily the euro.

### *Loss (Gain) on Investments*

From time to time, we hold certain investments in the common stock of private and publicly-traded companies, a number of non-marketable equity securities, and investments in rabbi trusts associated with our deferred compensation plans.

During the three months ended June 30, 2012 and 2011, we recorded net loss (gain) related to these investments of \$0.4 million, and \$(0.3) million, respectively. During the six months ended June 30, 2012 and 2011, we recorded net gains related to these investments of \$0.6 million, and \$0.8 million, respectively.

### *Other Expense (Income)*

Other income for the three months ended June 30, 2012 and 2011 was \$0.2 million and \$0.4 million, respectively. For the six months ended June 30, 2012 and 2011, other income was \$0.7 million and \$0.5 million, respectively.

### *Income Tax Expense*

In the three and six months ended June 30, 2012, we recorded income tax expense of \$7.6 million and \$10.4 million, respectively, as compared to \$6.1 million and \$5.9 million, respectively in the same periods in 2011. In





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the first quarter of 2011, the Company implemented certain legal entity changes to reduce complexity and simplify our corporate organizational structure and tax accounting provision process. As a result, approximately \$3.6 million of valuation allowances related to state deferred tax assets, generated primarily from net operating losses, were reversed as we concluded it was more likely than not that we will now be able to utilize the deferred tax assets in future periods. The legislation providing for the research and development tax credit expired in 2011 and has not been extended.

The Company anticipates that the effective income tax rate for full year 2012, excluding discrete items and any changes in law to extend the research and development tax credit, will be approximately 33.5%.

**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*

	Six Months Ended June 30,	
	<u>2012</u>	<u>2011</u>
	(in thousands, except DSO and turns)	
<i>Key Working Capital Items</i>		
Cash provided by operating activities	\$ 65,866	\$ 27,809
Cash, cash equivalents, and short-term investments	\$ 539,561	\$ 591,535
Long-term U.S. corporate & government agency bonds	\$ 36,691	\$ -
Accounts receivable, net	\$ 179,371	\$ 152,436
Days Sales Outstanding ( DSOs )	46	48
Inventory	\$ 102,361	\$ 113,020
Inventory turns	7.8	6.1
<i>Key Financing Items</i>		
Convertible notes at face value	\$ 232,050	\$ 237,050
Convertible notes at book value	\$ 215,823	\$ 208,336
<i>Key Shareholder Equity Items</i>		
Cash used for share repurchases	\$ 41,551	\$ 57,647
<i>Capital Expenditures</i>	\$ 9,256	\$ 12,547

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

- Liquidity ensure that we have sufficient cash resources or other short term liquidity to manage day to day operations
- Growth implement a plan to ensure that we have adequate capital resources, or access thereto, fund internal growth and execute acquisitions while retiring our convertible notes in a timely fashion.
- Share repurchases opportunistically repurchase our common stock.

Below is a description of key actions taken and an explanation as to their potential impact:

*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.



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Accounts receivable increased during the first six months of 2012 as compared to 2011 primarily as a result of higher sales. DSOs decreased during the first six months of 2012 as compared to 2011. This decrease was primarily the result of payment patterns of our customers and timing of shipments to customers. Looking forward, it is possible that DSOs may increase dependent upon our customer mix and payment patterns, particularly if international sales increase.

Inventory at the end of the second quarter of 2012 was \$10.7 million lower than the end of the second quarter of 2011. Inventory turns during the first six months of 2012 were 7.8 as compared to 6.1 in the same period of 2011. The decrease in inventory reflects higher sales and the sale of \$3.6 million of net inventory of the ECCO product line.

### *Common Share Repurchases*

During the first half of 2012, we repurchased 3.7 million shares of our common stock for \$41.6 million at an average stock price of \$11.28. During the first half of 2011, ARRIS repurchased 5.1 million shares of our common stock for \$57.6 million at an average stock price of \$11.37.

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

We believe our current liquidity position, where we have approximately \$539.6 million of cash, cash equivalents, and short-term investments and \$36.7 million of long-term marketable securities on hand as of June 30, 2012, 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 2010, ARRIS repurchased 6.8 million shares of the Company's common stock at an average price of \$10.24 per share for an aggregate consideration of approximately \$69.3 million.

In May 2011, the share repurchase authorization amount under the 2009 plan was exhausted. In the second quarter of 2011, the Board authorized a new plan for the Company to purchase up to \$150 million of the Company's common stock. During 2011, ARRIS repurchased 10.0 million shares of our common stock at an average price of \$10.95 per share for an aggregate consideration of approximately \$109.1 million.

During the first three month of 2012, ARRIS repurchased 2.3 million shares of the Company's common stock at an average price of \$11.32 per share, for an aggregate consideration of approximately \$26.3 million. During the second quarter of 2012, ARRIS repurchased approximately 1.4 million shares of the Company's common stock at an average price of \$11.21 per share for an aggregate consideration of approximately \$15.2 million.

As of June 30, 2012, the remaining authorized amount for future repurchases was \$30.0 million.

### *Commitments*

Our contractual obligations are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011. There has been no material change to our contractual obligations during the first six months of 2012.

### *Off-Balance Sheet Arrangements*

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

**Table of Contents***Cash Flow*

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

	For the Six Months Ended June 30,	
	<u>2012</u>	<u>2011</u>
Cash provided by operating activities	\$ 65,866	\$ 27,809
Cash provided by (used in) investing activities	(63,199)	24,086
Cash used in financing activities	(39,147)	(44,735)
Net increase (decrease) in cash	\$ (36,480)	\$ 7,160

**Operating Activities:**

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

	For the Six Months Ended June 30,	
	<u>2012</u>	<u>2011</u>
Net income	\$ 20,800	\$ 28,254
Adjustments to reconcile net income to cash provided by operating activities	37,505	31,438
Net income including adjustments	58,305	59,692
Increase in accounts receivable	(27,743)	(26,503)
(Increase) decrease in inventory	9,996	(11,257)
Increase (decrease) in accounts payable and accrued liabilities	5,136	(15,480)
All other net	20,172	21,357
Cash provided by operating activities	\$ 65,866	\$ 27,809

Net income, including adjustments, decreased \$1.4 million during the first six months of 2012 as compared to 2011.

Accounts receivable increased by \$27.7 million during the first six months of 2012. This increase was primarily as a result of higher sales and payment patterns of our customers.

Inventory decreased by \$10.0 million during the first six months of 2012. The decrease was due to higher sales and the sale of the ECCO product line.

Accounts payable and accrued liabilities increased by \$5.1 million. Accounts payable increased due to increased purchases resulting from higher sales.

All other accounts, net, includes the changes in other receivables, income taxes payable (recoverable), and prepaids. 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. The net change during the first six months of 2012 was approximately \$20.2 million.

**Investing Activities:**

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

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	For the Six Months Ended June 30,	
	<u>2012</u>	<u>2011</u>
Purchases of property, plant and equipment	\$ (9,256)	(12,547)
Cash proceeds from sale of property, plant and equipment		43
Purchases of investments	(140,353)	(142,841)
Sales of investments	83,161	179,431
Cash proceeds from sale of product line	3,249	
Cash provided by (used in) investing activities	\$ (63,199)	\$ 24,086

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*Purchases of Property, Plant and Equipment* This represents capital expenditures which are mainly for test equipment, laboratory equipment, and computing equipment. We anticipate investing approximately \$25 million in fiscal year 2012.

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

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

*Cash Proceeds from Sale of Product Line* This represents the cash proceeds we received from the sale of our ECCO product line.

**Financing Activities:**

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

	For the Six Months Ended June 30,	
	<u>2012</u>	<u>2011</u>
Repurchase of common stock	\$ (41,551)	(57,647)
Excess income tax benefits from stock-based compensation plans	2,460	3,247
Repurchase of shares to satisfy employee tax withholdings	(8,052)	(8,245)
Proceeds from issuance of common stock	7,996	17,910
Cash provided by (used in) financing activities	\$ (39,147)	\$ (44,735)

*Repurchase of Common Stock* During the first six months of 2012, ARRIS repurchased approximately 3.7 million shares of the Company's common stock at an average price of \$11.28 per share for an aggregate consideration of approximately \$41.6 million. During the first six months of 2011, ARRIS repurchased approximately 5.1 million shares of the Company's common stock at an average price of \$11.37 per share for an aggregate consideration of approximately \$57.6 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 June 30, 2012, 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 and Taiwan, and we have research and development centers in China, Israel, and Ireland. 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. We have certain predictable expenditures for international

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operations in local currency. We use a hedging strategy and enter into forward or currency option contracts based on a percentage of expected foreign currency expenses. The percentage can vary, based on the predictability of the revenues denominated in the foreign currency.



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### *Financial Instruments*

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

ARRIS executes letters of credit in favor of certain landlords and vendors to guarantee performance on lease and insurance contracts. Additionally, we have cash collateral account agreements with our financial institutions as security against potential losses with respect to our foreign currency hedging activities. The letters of credit and cash collateral accounts are reported as restricted cash. As of June 30, 2012 and December 31, 2011, we had approximately \$3.9 million and \$4.1 million outstanding, respectively, of cash collateral.

### *Cash, Cash Equivalents, and Short-Term Investments*

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

From time to time, we hold certain investments in the common stock of publicly-traded companies, which are classified as available-for-sale. As of June 30, 2012 and December 31, 2011 our holdings in these investments were \$5.6 million and \$4.8 million, respectively. Changes in the market value of these securities are recorded in other comprehensive income and gains or losses on related sales of these securities are recognized in income (loss).

ARRIS holds cost method investments in private companies. These investments are recorded at \$3.6 and \$1.0 million as of June 30, 2012 and December 31, 2011, respectively. Due to the fact the investments are in a private companies, we are exempt from estimating the fair values on an interim basis. However, ARRIS is required to estimate the fair value if there has been an identifiable event or change in circumstance that may have a significant adverse effect on the fair value of the investment. Each quarter, we evaluate our investments for any other-than-temporary impairment, by reviewing any capital transactions, the current revenues, bookings and long-term plan of the private company. During the evaluation performed as of December 31, 2011, ARRIS concluded that one of the private companies would be depleting cash balances in early 2012. Further, ARRIS was notified that the private company intends to raise capital by offering a new round of financing to its existing and new investors. ARRIS concluded that the investee's need to raise further capital was an indicator of impairment and therefore, performed steps to determine the fair value of its investment in the private company. ARRIS was unable to apply traditional valuation techniques as the required inputs to these techniques are unavailable. ARRIS determined that the best estimate of the fair value of its investment was to calculate it based upon the preliminary indication of value related to the new round of financing. As a result of these considerations, ARRIS recorded an other-than-temporary impairment on its investment of \$3.0 million in the fourth quarter of 2011. During the second quarter of 2012, the same private company continued its efforts to raise capital, and as part of this process, a new valuation was performed. The results indicated a further reduction in the valuation of the private company. As a result, ARRIS concluded that its investment was further impaired and recorded an incremental other-than-temporary impairment of \$0.5 million in the second quarter of 2012. As of June 30, 2012, the balance of this investment is \$0.6 million, and the balance of the two new investments is their original cost of \$3.0 million. See Note 4 of Notes to the Consolidated Financial Statements for further disclosures related to the fair value of these investments.

We have a deferred compensation plan that was available to certain current and former officers and key executives of C-COR. During 2008, this plan was merged into a new non-qualified deferred compensation plan which is also available to our key executives. Employee compensation deferrals and matching contributions are held in a rabbi trust, which is a funding vehicle used to protect the deferred compensation from various events (but not from bankruptcy or insolvency).

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

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

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

### *Capital Expenditures*

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS' capital expenditures were \$9.3 million in the first six months of 2012 as compared to \$12.5 million in the first six months of 2011. Management expects to invest approximately \$25 million in capital expenditures for the fiscal year 2012.

### **Critical Accounting Policies and Estimates**

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

Our critical accounting policies and estimates are disclosed in our Form 10-K for the year ended December 31, 2011, as filed with the SEC. Our critical accounting estimates have not changed in any material respect during the six months ended June 30, 2012.

### **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 regarding the acquisition of BigBand and other statements using terms such as "may," "expect," "anticipate," "intend," "estimate," "believe," "plan," "continue," "could be," or similar variations or the negative thereof, constitute 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, Part II, "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**

There have been no material changes with respect to the information appearing in Part II, Item 7A., "Quantitative and Qualitative Disclosures About Market Risk," of our Annual Report on Form 10-K for the year ended December 31, 2011.

### **Item 4. CONTROLS AND PROCEDURES**

(a) *Evaluation of Disclosure Controls and Procedures.* Our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-

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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

We accrue a liability for legal contingencies when we believe that it is both probable that a liability has been incurred and that we can reasonably estimate the amount of the loss. ARRIS reviews these accruals and adjusts them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and our views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in our accrued liabilities would be recorded in the period in which such determinations are made. Unless noted otherwise, for the matters referenced below, the liability is not probable or the amount cannot be reasonably estimated, and therefore, accruals have not been made.

Due to the nature of our business, it is subject to patent infringement claims, including current suits against us or one or more of our wholly-owned subsidiaries or one or more of our customers who may seek indemnification from us, alleging infringement by various Company products and services. We believe that we have meritorious defenses to the allegation made in the pending cases and intend to vigorously defend these lawsuits; however, we are unable currently to determine the ultimate outcome of these or similar matters. In addition, we are a defendant in various litigation matters generally arising out of the normal course of business. 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. However, since it is difficult to predict the outcome of these matters, it is possible that the ultimate outcomes will materially and adversely affect our business, financial position, results of operations or cash flows.

***British Telecom v. Cox and Cable One.*** C.A. No. 10-658 (SLR), U.S. District Court, District of Delaware. On August 5, 2010 BT sued Cox and Cable One alleging infringement of four BT U.S. patents, nos. 5,142,532, 5,526,350, 6,538,989 and 6,665,264, and subsequently amended the complaint to include four additional U.S. patents, nos. 5,790,643, 5,923,247, 6,205,216 and 6,473,742. Cox and Cable One have asked ARRIS (and other suppliers) to indemnify them. Comcast has also requested indemnification for a similar litigation with British Telecom over the same patents, and has filed a separate suit against BT for infringement of unrelated patents. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify Cable One and Cox, pay royalties and/or cease utilizing certain technology.

***ARRIS v. SeaChange Int'l (previously nCube v. SeaChange).*** C.A. No. 01-011 (JJF). U.S. District Court, District of Delaware. In May 2002, a jury found that video-on-demand products and software sold by SeaChange International ( SeaChange ) willfully infringed various claims of ARRIS' U.S. patent No. 5,805,804. The jury also determined that a 7% royalty rate was applicable to SeaChange's infringing sales. In April 2004, the District Court awarded enhanced damages and attorneys' fees based on the jury's finding of willful infringement. In January 2006, the Federal Circuit affirmed the jury's findings of willful infringement and the District Court's award of enhanced damages and attorneys' fees. In April 2006, the District Court entered a permanent injunction that, among other things, enjoined SeaChange from selling video-on-demand products and software that infringe U.S. patent no. 5,805,804. Following the District Court's entry of the permanent injunction, SeaChange initiated re-examination proceedings of the infringed claims before the United States Patent and Trademark Office ( USPTO ). The USPTO determined that most of the patent claims were patentable without any modification, including the infringed claim at issue in the contempt action.

In July 2009, ARRIS filed a motion for contempt, seeking to enforce the permanent injunction and an award of sanctions for SeaChange's continued sales of the video-on-demand products and software. In August 2009, in response to ARRIS' motion for contempt, SeaChange filed a declaratory-judgment suit seeking an order that its video-on-demand products and software do not infringe U.S. patent no. 5,805,804. In June 2010, the District

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Court stayed SeaChange's declaratory-judgment suit in favor of proceeding with ARRIS' motion for contempt. To date, ARRIS has introduced evidence of infringement and support for sanctions based on SeaChange's sales of its video-on-demand products and software since 2002. ARRIS has requested that enhanced sanctions be awarded. In March 2011, the District Court conducted a hearing with respect to ARRIS' motion for contempt. In September 2011, the District Court issued an opinion, confirming that the contempt proceedings were appropriate and further noting its present inclination to find no colorable difference between SeaChange's infringing product and SeaChange's current product. The District Court also stated that further proceedings may be necessary before the Court will be able to make a final finding. A hearing to determine whether contempt occurred was held on March 1, 2012. Post-hearing briefing was completed on May 10, 2012 and a decision from the court is expected.

**Multiservice Solutions v. MSOs** C.A. No. 6:11-cv-00114, Eastern District of Texas. In March 2011, Multiservice Solutions filed suit against 4 MSOs alleging infringement of US patent no. 5,774,527 by all parties to the suit, and US patent no. 5,715,315 by one party to the suit, relating to integrated voice, data and video devices. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past and future infringement. This case was recently dismissed without prejudice.

**Olympic Developments AG v. MSOs** C.A. No. 2:11-cv-00612, Central District of California. In January 2011, Olympic Developments AG filed suit against 9 cable and satellite service operators alleging infringement of two US patents, nos. 5,475,585 and 6,246,400, relating to VOD products and services. Certain of our customers have requested that we provide indemnification. The Court is currently awaiting an answer to be filed by Comcast, and will thereafter set a scheduling conference. The complaint requests unspecified damages for past infringement and an injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

**Bear Creek Technologies v. MSOs** C.A.No. 2:11-cv-00103, District of Delaware. In February 2011, Bear Creek sued MSOs, Telcos and other VoIP service providers for infringement of US patent no. 7,889,722, relating to EMTAs. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

**GTZM Technology Ventures Ltd. v. MSOs** C.A. No. 1:11-cv-00790, District of Delaware. In September 2011, GTZM Technology Ventures filed suit against 14 cable and telephone service providers alleging infringement of US patent no. 5,455,859, relating to EMTAs. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past infringement and injunction against future infringement. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

**CyberFone (LVL Patent Group, LLC) v. MSOs** C.A. No. 1:11-cv-00828, District of Delaware. On September 15, 2011, LVL Patent Group filed suit against 14 cable service providers alleging infringement of US patent no. 6,044,382, relating to VOD products and services. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

**CyberFone Systems, LLC v. MSOs** C.A. No. 1:2012cv00109, etc.; District of Delaware. On January 30, 2012, Cyberfone filed separate suits against 13 cable service providers alleging infringement of U.S. patent No. 8,019,060, relating to video on demand services. Certain of our customers have requested that we provide indemnification. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the MSOs, pay royalties and/or cease utilizing certain technology.

**Bernstein, et al v. BigBand Networks, Inc., et al.** During October 2011, five lawsuits were filed against BigBand Networks, BigBand Networks directors and ARRIS for breach of fiduciary duty claiming, among other things, the price that ARRIS agreed to pay to acquire BigBand Networks is too low and seeking injunctive relief and

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monetary damages. Four suits were filed in California and one in Delaware. The suits are *Bernstein v. BigBand Networks, Inc., et al.* Civil Action No. CIV509018, *Naveh v. BigBand Networks, Inc., et al.* Civil Action No. CIV509114, and *Bushaskey v. BigBand Networks, Inc., et al.* Civil Action No. CIV 509188 and *Schnaider v. BigBand Networks, Inc., et al.* Civil Action No. CIV509158. The Delaware case is *Amir v. BigBand Networks, Inc., et al.* Civil Action No. CA 6992-VCG. A tentative settlement of the cases subject to court approval, has been reached which was reflected in the Company's financial statements as of December 31, 2011.

***KTech Telecommunications Inc. v. Time Warner Cable Inc.*** C.A. 2:11-cv-09373, Central District of California. On November 9, 2011, KTech Telecommunications filed suit against Time Warner Cable (TWC) alleging infringement of U.S. patent nos. 6,785,903, 7,487,533, 7,761,893, and 7,984,469. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify the TWC, pay royalties and/or cease utilizing certain technology.

***Sprint v. Time Warner Cable and Comcast*** C.A. 11-cv-2684, District of Kansas. On December 19, 2011, Sprint filed suit against Time Warner Cable (TWC) and Comcast alleging infringement of 12 patents alleged to cover various voice over internet protocol technologies. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify TWC and/or Comcast, pay royalties and/or cease utilizing certain technology.

***Williamson (At Home) v. Verizon and AT&T*** C.A. 11-cv-04948, Southern District of New York. On July 19, 2011, Williamson filed suit against Verizon and AT&T on behalf of the At Home bankruptcy estate alleging infringement of four patents alleged to cover regionalized multicasting services. The complaint requests unspecified damages for past infringement and injunction against future infringement. To date, no evidence of damages has been introduced. It is premature to assess the likelihood of a favorable outcome. In the event of an unfavorable outcome, ARRIS may be required to indemnify AT&T, pay royalties and/or cease utilizing certain technology.

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

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**Item 1A. Risk Factors**

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

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

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

Several of our customers have accumulated significant levels of debt. These high debt levels, coupled with the current turbulence and uncertainty in the capital markets, may impact their access to capital in the future. Even if the financial health of our customers remains intact, these customers may not purchase new equipment at levels we have seen in the past or expect in the future. The economy and financial markets continue to be impacted by housing market disruptions and foreclosures as well as the material global economic disruptions. We cannot predict the impact if any of the recent financial market turmoil, or of specific customer financial challenges on our customers' 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;
- Casa Systems, Inc.;
- Cisco Systems, Inc.;
- Commscope, Inc.;
- Concurrent Computer Corporation;
- Ericsson (TandbergTV);
- Harmonic, Inc.;
- Motorola Mobility, Inc.;
- Pace Plc;
- SeaChange, Inc.;
- SMC Networks;
- Technicolor, Inc.;
- TVC Communications, Inc.; and
- Ubee Interactive, Inc.

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



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

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

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

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

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

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

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

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

Our two largest customers (including their affiliates, as applicable) are Comcast and Time Warner Cable. For the six months ended June 30, 2012, sales to Comcast accounted for approximately 27.3% and sales to Time Warner Cable accounted for approximately 18.8% 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



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

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

In the past, we have made acquisitions of and investments in businesses, products, and technologies to complement or expand our business. While we have no announced plans for additional acquisitions, future acquisitions are part of our strategic objectives and may occur. If we identify an acquisition candidate, we may not be able to successfully negotiate or finance the acquisition or integrate the acquired businesses, products, or technologies with our existing business and products. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, amortization expenses, and substantial goodwill. We will test the goodwill that is created by acquisitions, at least annually and will record an impairment charge if its value has declined. For instance, in the fourth quarter of 2011, we recorded a substantial impairment charge with respect to the goodwill that was created as part of a prior acquisition.

Any integration process with respect to completed acquisitions may be complex and time consuming, may be disruptive to the business and may cause an interruption of, or a distraction of management's attention from, the business as a result of a number of obstacles, including but not limited to:

- the loss of key customers of the acquired company;
- the incurrence of unexpected expenses and working capital requirements;
- a failure of our due diligence process to identify significant issues or contingencies;
- difficulties assimilating the operations and personnel of the acquired company;
- our inability to retain key personnel of acquired entities;
- our inability to achieve the financial and strategic goals for the acquired and combined businesses; and
- difficulty in maintaining internal controls, procedures and policies.

Any of the foregoing obstacles, or a combination of them, could increase selling, general and administrative expenses in absolute terms and/or as a percentage of net sales, which could in turn negatively impact our operating results and cash flows.

### ***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 expect to 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 several proceedings (and other proceedings have been threatened) in which our customers were sued for patent infringement and sued, or made claims against, us and other suppliers for indemnification, and we may become involved in similar litigation involving these and other customers in the future. These claims, regardless of their merit, result in costly litigation, divert the time, attention and resources of our management, delay our product shipments, and, in some cases, require us to enter into royalty or licensing agreements. If a claim of product infringement against us is successful and we fail to obtain a license or develop non-infringing technology, our business and operating results could be materially and adversely affected. In addition, the payment of any damages or any necessary licensing fees or indemnification costs associated with a patent infringement claim could be material and could also materially adversely affect our operating results. See Part II, Item 1, Legal Proceedings.

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### ***We have substantial goodwill and amortizable intangible assets.***

Our financial statements reflect substantial goodwill and intangible assets, approximately \$304.6 million as of June 30, 2012, that was recognized in connection with the acquisitions that we have made. We annually (and more frequently if changes in circumstances indicate that the asset may be impaired) review the carrying amount of our goodwill in order to determine whether it has been impaired for accounting purposes. In general, if the fair value of the corresponding reporting unit's goodwill is less than the carrying value of the goodwill, we record an impairment charge. The determination of fair value is dependent upon a number of factors, including assumptions about future cash flows and growth rates that are based on our current and long-term business plans. With respect to the amortizable intangible assets, ARRIS tests recoverability when events or changes in circumstances indicate that their carrying amounts may not be recoverable. Examples of such circumstances include, but are not limited to, operating or cash flow losses from the use of such assets or changes in our intended uses of such assets. If the Company determines that an asset or asset group is not recoverable, then the Company would record an impairment charge if the carrying value of the asset or asset group exceeds its fair value. Fair value is based on estimated discounted future cash flows expected to be generated by the asset or asset group. The assumptions underlying cash flow projections would represent management's best estimates at the time of the impairment review.

No goodwill impairment was recorded in the first six months of 2012. During the fourth quarter of 2011, we recorded a non-cash goodwill impairment charge of \$41.2 million and a non-cash intangible asset impairment charge of \$47.4 million relating to our MCS reporting unit. We also recorded a non-cash goodwill impairment charge of \$128.9 million and \$80.4 million related to the ATS and MCS reporting units, respectively, during the fourth quarter of 2008. As the ongoing expected cash flows and carrying amounts of our remaining goodwill are assessed, changes in the economic conditions, changes to our business strategy, changes in operating performance or other indicators of impairment could cause us to realize additional impairment charges in the future. For additional information, see the discussion under Critical Accounting Policies in Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the United States Securities and Exchange Commission (SEC).

### ***We may have difficulty in forecasting our sales.***

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

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

The level of our MCS 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 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;



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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. Further, we have research and development centers in China, Ireland, and Israel. The governments of these foreign countries may pass laws that impair our operations, such as laws that impose exorbitant tax obligations or nationalize these manufacturing facilities. These countries may also be subject to political and civil unrest which may adversely impact our operations.

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

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

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

***Regional instability in Israel may adversely affect business conditions, including the operations of our contract manufacturers, and may disrupt our operations and negatively affect our operating results.***

A portion of our research and development operations and a portion of our contract manufacturing occur in Israel. As of June 30, 2012, we had approximately 120 full-time employees located in Israel. We also have customer service, marketing and general and administrative employees at our facility. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel, and any major hostilities there involving Israel or the interruption or curtailment of trade between Israel and its trading partners could significantly harm our business. In addition, in the past, Israel and companies doing business with Israel have been the subject of an economic boycott. Israel has also been and is subject to civil unrest and terrorist activity, with varying levels of severity, for the last decade. Security and political conditions may have an adverse impact on our business in the future. Hostilities involving Israel or the interruption or curtailment of trade between Israel and its trading partners could adversely affect our operations and make it more difficult for us to retain or recruit qualified personnel in Israel.

In addition, most of our employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and several have been called for active military duty in connection with intermittent hostilities over the years. Should hostilities in the region escalate again, some of our employees would likely be called to active military duty, possibly resulting in interruptions in our sales and development efforts and other impacts on our business and operations, which we cannot currently assess.

***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;

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our ability to continue channel partner arrangements into the future since most are for a limited term and subject to mutual agreement to extend;  
 a reduction in gross margins realized on sale of our products; and  
 a diminution of contact with end customers which, over time, could adversely impact our ability to develop new products that meet customers' evolving requirements.

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

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

future announcements concerning us, key customers or competitors;  
 quarterly variations in operating results;  
 changes in financial estimates and recommendations by securities analysts;  
 developments with respect to technology or litigation;  
 the operating and stock price performance of our competitors; and  
 acquisitions and financings

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

***Cyber-security incidents, including data security breaches or computer viruses, could harm our business by disrupting our delivery of services, damaging our reputation or exposing us to liability.***

We receive, process, store and transmit, often electronically, the confidential data of our clients and others. Unauthorized access to our computer systems or stored data could result in the theft or improper disclosure of confidential information, the deletion or modification of records or could cause interruptions in our operations. These cyber-security risks increase when we transmit information from one location to another, including transmissions over the Internet or other electronic networks. Despite implemented security measures, our facilities, systems and procedures, and those of our third-party service providers, may be vulnerable to security breaches, acts of vandalism, software viruses, misplaced or lost data, programming and/or human errors or other similar events which may disrupt our delivery of services or expose the confidential information of our clients and others. Any security breach involving the misappropriation, loss or other unauthorized disclosure or use of confidential information of our clients or others, whether by us or a third party, could (i) subject us to civil and criminal penalties, (ii) have a negative impact on our reputation, or (iii) expose us to liability to our clients, third parties or government authorities. Any of these developments could have a material adverse effect on our business, results of operations and financial condition.

***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

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dissolution. Our Certificate of Incorporation permits our board of directors to issue preferred shares without first obtaining stockholder approval. If we issued preferred shares, these additional securities may have dividend or liquidation preferences senior to the common shares. If we issue convertible preferred shares, a subsequent conversion may dilute the current common stockholders' interest.

### **Item 4. MINE SAFETY DISCLOSURE**

Not applicable

### **Item 6. EXHIBITS**

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



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**SIGNATURES**

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

ARRIS GROUP, INC.

s/ David B. Potts  
David B. Potts  
Executive Vice President, Chief Financial

Officer, Chief Accounting Officer, and

Chief Information Officer

Dated: August 6, 2012