ARRIS GROUP INC
Form 10-Q
November 09, 2005

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

FORM 10-Q
For the quarter ended September 30, 2005
of
ARRIS GROUP, INC.
A Delaware Corporation
IRS Employer Identification No. 58-2588724
SEC File Number 000-31254
3871 Lakefield Drive
Suwanee, GA 30024
(770) 622-8400

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 an accelerated filer and is not a shell company (as defined in Rule 12b-2 of the Exchange Act). As of October 31, 2005, 105,422,942 shares of the registrant s Common Stock, $0.01 par value, were outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

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

	September 30, 2005 (unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 48,194	$ 25,072
Short-term investments, at fair value	46,250	78,000
Total cash, cash equivalents and short-term investments	94,444	103,072
Restricted cash	4,053	4,017
Accounts receivable (net of allowances for doubtful accounts of $3,268 in 2005 and $3,829 in 2004)	95,791	55,661
Other receivables	887	420
Inventories, net	90,122	92,636
Other current assets	20,198	9,416
Total current assets	305,495	265,222
Property, plant and equipment (net of accumulated depreciation of $67,165 in 2005 and $61,146 in 2004)	26,483	27,125
Goodwill	150,569	150,569
Intangibles (net of accumulated amortization of $106,440 in 2005 and $105,446 in 2004)	1,138	1,672
Investments	3,347	3,620
Other assets	395	2,470
	$ 487,427	$ 450,678
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 25,602	$ 30,640
Accrued compensation, benefits and related taxes	16,083	14,845
Other accrued liabilities	29,828	32,111
Total current liabilities	71,513	77,596
Long-term debt, net of current portion		75,000
Other long-term liabilities	16,683	16,781
Total liabilities	88,196	169,377
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; 105.1 million and 87.7 million shares issued and outstanding in 2005 and 2004, respectively	1,065	889
Capital in excess of par value	727,249	644,838
Accumulated deficit	(327,520)	(357,038)
Unrealized gain on marketable securities	975	706
Unearned compensation		(4,566)
Unfunded pension losses	(3,345)	(3,345)
Unrealized gain on derivatives	991	
Cumulative translation adjustments	(184)	(183)
Total stockholders equity	399,231	281,301
	$ 487,427	$ 450,678

See accompanying notes to the consolidated financial statements.

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ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net sales	$ 200,957	$ 128,409	$ 499,082	$ 360,574
Cost of sales	145,979	92,663	366,230	248,182
Gross margin	54,978	35,746	132,852	112,392
Gross margin %	27.4%	27.8%	26.6%	31.2%
Operating expenses:				
Selling, general and administrative expenses	19,915	17,122	54,158	53,161
Provision for doubtful accounts	155	621	(355)	917
Research and development expenses	15,954	14,839	45,091	47,339
Restructuring and impairment charges	34	56	430	7,107
Amortization of intangibles	218	6,206	993	24,055
Total operating expenses	36,276	38,844	100,317	132,579
Operating income (loss)	18,702	(3,098)	32,535	(20,187)
Other expense (income):				
Interest expense	11	1,022	2,033	3,667
Loss on debt retirement			2,372	4,406
Loss (gain) on investments	(60)	150	(60)	1,589
Equity loss on unconsolidated affiliate			75	
Loss (gain) in foreign currency	288	(235)	145	(96)
Other expense (income), net	(694)	(325)	(1,733)	(834)
Income (loss) from continuing operations before income taxes	19,157	(3,710)	29,703	(28,919)
Income tax expense (benefit)	307	38	242	84
Net income (loss) from continuing operations	18,850	(3,748)	29,461	(29,003)
Income from discontinued operations	(30)	42	56	1,213
Net income (loss)	$ 18,820	$ (3,706)	$ 29,517	$ (27,790)
Net income (loss) per common share - Basic:				
Income (loss) from continuing operations	$ 0.18	$ (0.04)	$ 0.31	$ (0.34)
Income from discontinued operations	0.00	0.00	0.00	0.01

Net income (loss)	$ 0.18	$ (0.04)	$ 0.31	$ (0.33)
Diluted:				
Income (loss) from continuing operations	$ 0.18	$ (0.04)	$ 0.31	$ (0.34)
Income from discontinued operations	0.00	0.00	0.00	0.01
Net income (loss)	$ 0.18	$ (0.04)	$ 0.31	$ (0.33)
Weighted average common shares:				
Basic	104,434	87,347	93,768	84,440
Diluted	107,049	87,347	95,368	84,440

See accompanying notes to the consolidated financial statements.

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

	Nine Months Ended September 30,	
	2005	**2004**
Operating activities:		
Net income (loss)	$ 29,517	$ (27,790)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	7,528	7,812
Amortization of intangibles	993	24,055
Stock compensation expense	4,341	2,244
Amortization of deferred finance fees	305	537
Provision for doubtful accounts	(355)	917
Loss on disposal of fixed assets	131	97
Loss on investments		1,589
Equity loss on unconsolidated affiliate	75	
Loss on debt retirement	2,372	4,406
Impairment of long-lived assets	291	
Gain on discontinued product lines	(56)	(1,213)
Loss (gain) on derivative instrument	(666)	25
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	(39,525)	(9,113)
Other receivables	(467)	(1,542)
Inventory	2,824	(9,720)
Accounts payable and accrued liabilities	(6,903)	26,230
Other, net	(9,478)	(6,166)
Net cash provided by (used in) operating activities	(9,073)	12,368
Investing activities:		
Purchases of property, plant and equipment	(7,586)	(7,183)
Cash proceeds from sale of property, plant and equipment	40	
Cash paid for acquisition, net of cash acquired	(89)	(50)
Purchases of short-term investments	(51,250)	(89,750)
Disposals of short-term investments	83,032	39,750
Purchases of equity investments	(259)	
Net cash provided by (used in) investing activities	23,888	(57,233)
Financing activities:		
Payments on capital lease obligations		(14)
Payments on debt obligations		(1,163)
Proceeds from issuance of stock	8,307	7,025

Net cash provided by (used in) financing activities	8,307	5,848
Net increase (decrease) in cash and cash equivalents	23,122	(39,017)
Cash and cash equivalents at beginning of period	25,072	74,882
Cash and cash equivalents at end of period	$ 48,194	$ 35,865

See accompanying notes to the consolidated financial statements.

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

	Nine Months Ended September 30,	
	2005	**2004**
Noncash investing and financing activities:		
Net tangible assets acquired, excluding cash	$ 799	$
Investment in acquired company	(1,325)	
Net liabilities assumed	(76)	50
Intangible assets acquired	691	
Cash paid for acquisition, net of cash acquired	$ 89	$ 50
Landlord funded leasehold improvements	$	$ 785
Equity issued in exchange for 4 1/2% convertible subordinated notes due 2008	$ 75,000	$ 50,000
Equity issued for make-whole interest payment - 4 1/2% convertible subordinated notes due 2008	$ 2,372	$ 4,406

See accompanying notes to the consolidated financial statements.

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ARRIS GROUP, INC.
NOTES TO THE 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), headquartered in Suwanee, Georgia, is a leading developer, manufacturer and supplier of telephony, data, video, construction, rebuild and maintenance equipment for the broadband communications industry. The Company provides its customers with products and services that enable reliable, high-speed, two-way broadband transmission of video, telephony, and data. ARRIS operates in one segment, Communications.

The consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for a fair presentation of the consolidated financial statements for the periods shown. Additionally, certain prior period amounts have been reclassified to conform to the 2005 financial statement presentation. 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, 2004, as filed with the United States Securities and Exchange Commission (SEC).

Note 2. Impact of Recently Issued Accounting Standards

In June 2005, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3*. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS No. 154 to have an impact on the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment,* which requires all companies to measure compensation cost for all share-based payments at fair value. ARRIS elected to early adopt SFAS No. 123R on July 1, 2005, using the modified prospective approach. Under the modified prospective method, the fair value recognition provisions apply only to new awards or awards modified after July 1, 2005. Additionally, the fair value of existing unvested awards at the date of adoption is recorded in compensation expense over the remaining requisite service period. Results from prior periods have not been restated. Prior to the adoption of SFAS No. 123R, the Company recognized stock award forfeitures as they occurred. In accordance with SFAS No. 123R, ARRIS has changed its accounting policy as of July 1, 2005 from the actual forfeiture method to an estimate of expected forfeitures in calculating the compensation expense. The cumulative effect of this change in accounting principle was immaterial.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions.* The standard requires that nonmonetary asset exchanges should be recorded and measured at the fair value of the assets exchanged, with certain exceptions. Productive assets must be accounted for at fair value, rather than at carryover basis, unless neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or the transactions lack commercial substance. SFAS No. 153 states that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 becomes effective as of January 1, 2006. ARRIS does not expect the adoption of SFAS No. 153 to have a material impact on its results of operations.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs An Amendment of ARB No. 43, Chapter 4.* SFAS No. 151 requires that abnormal amounts of idle facility expense, freight, handling costs, and waste material be recognized as current period expense. Further, the standard requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151

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becomes effective as of January 1, 2006. ARRIS does not expect the adoption of SFAS No. 151 to have a material impact on its results of operations.

Note 3. Stock-Based Compensation

ARRIS grants stock options under its 2004 Stock Incentive Plan (2004 SIP) and issues stock purchase rights under its Employee Stock Purchase Plan (ESPP). Upon approval of the 2004 SIP by stockholders on May 26, 2004, all shares available for grant under the 2002 Stock Incentive Plan (2002 SIP) and the 2001 Stock Incentive Plan (2001 SIP) were cancelled. However, those shares subject to outstanding stock awards issued under the 2002 SIP and the 2001 SIP that are forfeited, cancelled, or expire unexercised; shares tendered (either actually or through attestation) to pay the option exercise price of such outstanding awards; and shares withheld for the payment of withholding taxes associated with such outstanding awards return to the share reserve of the 2002 SIP and 2001 SIP and shall be available again for issuance under those plans. All options outstanding as of May 26, 2004 under the 2002 SIP and 2001 SIP remained exercisable.

See Note 18 of Notes to the Consolidated Financial Statements in the 2004 Form 10-K for information regarding prior stock incentive plans.

Adoption of SFAS No. 123R, *Share-Based Payment*

The Company elected to early adopt the fair value recognition provisions of SFAS No. 123R on July 1, 2005, using the modified prospective approach. Prior to the adoption date, ARRIS used the intrinsic value method for valuing its awards of stock options and restricted stock and recorded the related compensation expense, if any, in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations. With the exception of variable stock option expense discussed below, no other stock-based employee or director compensation cost for stock options was reflected in net income (loss) prior to July 1, 2005, as all options granted had exercise prices equal to the market value of the underlying common stock on the date of grant. The Company records compensation expense related to its restricted stock awards and director stock units.

Prior to the adoption of SFAS No. 123R, ARRIS accounted for stock-based awards using the intrinsic value method in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations. The following table illustrates the pro forma effect on the three and nine months ended September 30, 2004 and the nine months ended September 2005 had the company applied the provisions of SFAS No. 123 in those periods (in thousands, except per share data):

	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Net income (loss), as reported	$ (3,706)	$ 29,517	$ (27,790)
Add: Stock-based employee compensation included in reported net income (loss), net of taxes	620	4,341	2,244
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of taxes	(3,415)	(14,237)*	(10,626)
Net income (loss), pro forma	$ (6,501)	$ 19,621	$ (36,172)
Net income (loss) per common share:			
Basic as reported	$ (0.04)	$ 0.31	$ (0.33)
Basic pro forma	$ (0.07)	$ 0.21	$ (0.43)
Diluted as reported	$ (0.04)	$ 0.31	$ (0.33)

Diluted	pro forma	$ (0.07)	$ 0.21	$ (0.43)

* Includes approximately $5.7 million of expense related to the acceleration of out-of-the-money options in the second quarter of 2005.

Stock Options

ARRIS grants stock options to certain employees that are settled in stock. Stock options generally vest over three or four years of service and have either seven or ten year contractual terms. The exercise price of an option is equal to the fair market value of ARRIS stock on the date of grant. The fair value of an option is estimated on the date of grant using the Black-Scholes option valuation model. Upon adoption of SFAS No. 123R, ARRIS engaged an independent third party to assist the Company in determining the Black-Scholes weighted average assumptions utilized in the valuation of options granted subsequent to July 1, 2005. The expected term of the awards granted are based upon a weighted average life of historical exercise activity of the grantee population. The volatility factors are based upon a combination of historical volatility from January 1, 2003, and estimates of implied volatility based on traded option contracts on ARRIS common stock. The risk-free interest rate is based upon the U.S. treasury strip yield at the grant date, using a remaining term equal to the expected life. The expected dividend yield is 0%, as the Company has not paid cash dividends on its common stock since its inception.

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In May 2005, the ARRIS Board of Directors approved the acceleration of outstanding options with exercise prices equal to $9.06 and above. All of these options were out-of-the-money at the time of acceleration, as the closing stock price on May 5, 2005 was $7.67. The acceleration covered options to purchase approximately 1.4 million shares of common stock, but did not involve any options held by directors or executive officers. The purpose of the acceleration was to reduce the expense that would be associated with these options in accordance with the provisions of SFAS No. 123R, *Share-Based Payment,* once adopted. The acceleration resulted in incremental stock-based employee compensation of approximately $5.7 million in the pro forma expense for the second quarter 2005.

In 2003, the Company offered to all eligible employees the opportunity to exchange certain outstanding stock options for restricted shares of ARRIS common stock. The Company s Board of Directors and its eight most highly compensated executive officers during 2002 were not eligible to participate in the offer. Employees tendered approximately 76% of the options eligible to be exchanged under the program and ARRIS cancelled options to purchase approximately 4.7 million shares of common stock and granted approximately 1.5 million restricted shares in exchange. The Company records a fixed compensation expense equal to the fair market value of the shares of restricted stock granted through the offer; this cost is being amortized over the four-year vesting period for the restricted shares. Prior to the adoption of SFAS No. 123R, all eligible options that were not tendered for exchange were subject to variable accounting. The variable accounting charge fluctuated in accordance with the market price of the ARRIS common stock at the end of each accounting period until such stock options were exercised, forfeited, or expire unexercised. In accordance with SFAS No. 123R, an equity award that previously was accounted for as a variable award under APB 25 should no longer be accounted for as a variable award. As of July 1, 2005, the grant-date fair value is used to recognize compensation cost for these options. Compensation expense (income) for those options subject to variable accounting was $0.0 million and $0.2 million for the three and nine month periods ended September 30, 2005, respectively. For the three and nine month periods ended September 30, 2004, the variable accounting has had no impact on the Company s results of operations.

A summary of activity of ARRIS options granted under its stock incentive plans is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Beginning balance, January 1, 2005	9,925,403	$ 8.48		
Grants	1,031,159	$ 6.63		
Exercised	(1,812,790)	$ 4.66		
Forfeited	(145,793)	$ 6.57		
Expired	(172,247)	$ 12.59		
Ending balance, September 30, 2005	8,825,732	$ 9.00	6.66	$ 36,838
Exercisable at September 30, 2005	5,942,022	$ 10.84	6.36	$ 17,636

The following assumptions were used in the Black-Scholes model to value ARRIS stock options granted during the third quarter 2005: expected life of 3.4 years; expected stock volatility of 56%; risk-free interest rate of approximately 4.0%; and no dividends during the expected term. The weighted average grant-date fair value of options granted during the first nine months of 2005 was $4.70. The total intrinsic value of options exercised during the nine months ended September 30, 2005 was approximately $10.0 million.

Restricted Stock (Non-Performance) and Stock Units

ARRIS grants restricted stock and stock units to certain employees and its outside directors. The Company records a fixed compensation expense equal to the fair market value of the shares of restricted stock granted on a straight-line basis over the requisite services period for the restricted shares.

The following table summarizes ARRIS unvested restricted stock (excluding performance-related) and stock unit transactions during the nine month period ending September 30, 2005:

	Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2005	1,026,963	$ 5.20
Granted	428,998	$ 6.68
Vested	(379,120)	$ 5.37
Forfeited	(28,889)	$ 5.25
Unvested at September 30, 2005	1,047,952	$ 5.74

Performance-Related Restricted Shares

ARRIS grants to certain employees restricted shares, in which the amount of shares is dependent upon performance conditions. The number of shares which will be issued ranges from zero to 150% of the target award. Compensation expense is recognized using the graded method and is based upon the fair market value of the shares estimated to be attained. The fair value of the restricted shares is estimated on the date of grant using the same valuation model as that used for stock options and other restricted shares. The Company currently believes that the performance goals will be achieved and compensation cost will be recognized. If such goals are not attained, any recognized compensation cost will be reversed.

In certain circumstances under its stock-based compensation plans, ARRIS allows for the vesting of employee awards to accelerate upon retirement or to continue to vest post-employment. Prior to the adoption of SFAS No. 123R, the Company has recognized the related compensation expense over the

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explicit service period. ARRIS will continue this practice for awards granted prior to July 1, 2005. For awards granted subsequent to the adoption date of SFAS No. 123R, the fair value of the award will be expensed over the employee s minimum service period rather than over the explicit vesting period. This could result in significant increases in compensation cost during periods in which stock awards are granted. Had the Company applied the accelerated expense recognition provisions of SFAS No. 123R to its awards (with acceleration clauses upon retirement) granted prior to July 1, 2005, compensation cost would have increased by approximately $1.0 million during the second quarter 2005. The impact would have been immaterial for the compensation expense recognized during 2004.

The following table summarizes ARRIS unvested performance-related restricted stock transactions during the nine month period ending September 30, 2005 (assumes maximum achievement of performance goals):

	Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2005		
Granted	301,955	$ 6.44
Vested		
Forfeited		
Unvested at September 30, 2005	301,955	$ 6.44

Employee Stock Purchase Plan (ESPP)

ARRIS offers an ESPP to certain employees. The plan is in accordance with Section 423 of the U.S. Internal Revenue Code, which provides that employees will not be immediately taxed on the difference between the market price of the stock and a discounted purchase price if it meets certain requirements. Participants can request that up to 10% of their base compensation be applied toward the purchase of ARRIS common stock under ARRIS ESPP. Purchases by any one participant are limited to $25,000 (based upon the fair market value) in any one year. The exercise price is the lower of 85% of the fair market value of the ARRIS common stock on either the first day of the purchase period or the last day of the purchase period. A plan provision which allows for the more favorable of two exercise prices is commonly referred to as a look-back feature. Under APB Opinion No. 25, *Accounting for Stock Issued to Employees,* the ESPP was deemed noncompensatory, and therefore, no compensation expense was recognized. However, SFAS No. 123R narrows the noncompensatory exception significantly; any discount offered in excess of five percent generally will be considered compensatory and appropriately recognized as compensation expense. Additionally, any ESPP offering a look-back feature is considered compensatory. ARRIS uses the Black-Scholes option valuation model to value to shares issued under the ESPP. The valuation is comprised of two components; the 15% discount of a share of common stock and 85% of a six month option held (related to the look-back feature).

Unrecognized Compensation Cost

As of September 30, 2005, there was approximately $14.4 million of total unrecognized compensation cost related to unvested share-based awards granted under the Company s incentive plans. This compensation cost is expected to be recognized over a weighted-average period of 2.3 years.

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Note 4. Pension Benefits

Components of Net Periodic Pension Benefit Cost

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
			(in thousands) (unaudited)	
Service cost	$ 105	$ 141	$ 353	$ 424
Interest cost	360	316	1,075	947
Expected return (loss) on plan assets	(266)	(223)	(784)	(670)
Amortization of prior service cost	110	140	339	419
Amortization of net (gain) loss	(27)	(24)	(67)	(70)
Net periodic pension cost	$ 282	$ 350	$ 916	$ 1,050

Employer Contributions

No minimum funding contributions are required in 2005; however, the Company made voluntary contributions to the plan of approximately $0.8 million during the three and nine months ended September 30, 2005, respectively.

Note 5. 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

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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 as increases to the warranty liability. ARRIS evaluates its warranty obligations on an individual product basis.

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

Information regarding the changes in ARRIS aggregate product warranty liabilities was as follows for the nine month period ended September 30, 2005 (in thousands):

Balance at December 31, 2004	$ 5,453
Accruals related to warranties (including changes in estimates)	4,603
Settlements made (in cash or in kind)	(2,610)
Balance at September 30, 2005	$ 7,446

Note 6. Discontinued Operations

In 2002, the Company sold its Keptel telecommunications and Actives product lines for net proceeds of $30.0 million and $31.8 million, respectively. During the first quarter 2004, the Company recognized a partial recovery with respect to inventory previously written off associated with an Argentinean customer. Of the total gain of $0.9 million, approximately $0.3 million related to the discontinued operations of the Actives and Keptel product lines. During the second quarter 2004, the Company recorded income from discontinued operations of $0.8 million with respect to the Actives and Keptel product lines as a result of changes in estimates related to real estate, vendor liabilities, and other accruals. During the three and nine months ended September 30, 2005, the Company recorded expense (income) of $30,000 and ($56,000) related to its reserves for discontinued operations. These adjustments were the result of the resolution of various vendor liabilities and other costs. As of September 30, 2005, the balance of the accrual was approximately $37,000 that relates to severance and other miscellaneous costs. The remaining payments are expected to be made in 2006.

Note 7. Business Acquisition

Acquisition of cXm Broadband

On April 1, 2005, the Company acquired the remaining 75% of the membership interest of cXm Broadband L.L.C., an entity that was previously accounted for under the equity method of accounting. From January 31, 2005 through March 31, 2005, ARRIS held a 25% ownership stake in the company. ARRIS decided to acquire the remaining membership interest in order to expand its existing Broadband product portfolio and to penetrate the Korean market for high-speed data access into multi-dwelling units. ARRIS acquired the remaining ownership percentage from the other shareholder for cash of $0.2 million and the assumption of certain liabilities. The purchase price also includes the Company s existing $1.3 million equity investment in the L.L.C.

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The following is a summary of the purchase price allocation to record our purchase of the net assets of cXm Broadband and is based upon an independent valuation of the assets. The purchase price was equal to the net tangible and intangible assets acquired (in thousands):

Cash paid to other shareholder	$ 67
Acquisition costs (legal fees, valuation fees)	22
Equity investment balance	1,325
Assumption of certain liabilities of cXm Broadband	76
Adjusted purchase price	$ 1,490
Allocation of purchase price:	
Net tangible assets acquired	$ 799
Existing technology and customer value (to be amortized over 3 years)	691
Total allocated purchase price	$ 1,490

Note 8. Restructuring and Impairment Charges

The Company s restructuring activities occurring after December 31, 2002 are accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.* Prior to December 31, 2002, all restructuring activities were accounted for in accordance with Emerging Issues Task Force Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).*

On December 31, 2004, the Company announced that it would close its office in Fremont, California, which previously housed the Atoga Systems product line. The marketing and support for certain products acquired as part of the Atoga Systems acquisition were transferred to other locations. The Company decided to close the office in order to reduce operating costs through consolidation of its facilities. The closure affected seven employees. In connection with these actions, the Company recorded a net charge of approximately $0.3 million in the fourth quarter of 2004, which included approximately $0.1 million related to remaining lease payments and $0.2 million of severance charges. As of September 30, 2005, the balance in the restructuring accrual was $0. Below is a table that summarizes the activity in the restructuring reserve (in millions):

	Lease Commitments	Severance	Total
Balance as of December 31, 2003	$	$	$
2004 Provision	0.1	0.2	0.3
Balance as of December 31, 2004	0.1	0.2	0.3
First quarter 2005 payments		(0.2)	(0.2)

Balance as of March 31, 2005		0.1	0.1
Second quarter 2005 payments		(0.1)	(0.1)
Balance as of September 30, 2005	$	$	$

During the first quarter of 2004, ARRIS consolidated two facilities in Georgia, giving the Company the ability to house many of its core technology, marketing, and corporate headquarters functions in a single building. This consolidation resulted in a restructuring charge of $6.2 million in the first quarter of 2004 related to lease commitments and the write-off of leasehold improvements and other fixed assets. As of September 30, 2005, approximately $2.8 million related to the lease commitments remained in the restructuring accrual to be paid. ARRIS expects the remaining payments to be made by the second quarter of 2009 (end of lease). Below is a table that summarizes the activity in the restructuring reserve (in millions):

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	Writedown of Leasehold Improvements	Lease Commitments	Total
Balance as of December 31, 2003	$	$	$
2004 Provision	1.1	5.1	6.2
Non-cash expense (disposal of assets)	(1.1)		(1.1)
2004 payments		(1.2)	(1.2)
Adjustments to accrual		0.2	0.2
Balance as of December 31, 2004		4.1	4.1
First quarter 2005 payments		(0.4)	(0.4)
First quarter 2005 adjustments to accrual		(0.2)	(0.2)
Balance as of March 31, 2005		3.5	3.5
Second quarter 2005 payments		(0.4)	(0.4)
Balance as of June 30, 2005		3.1	3.1
Third quarter 2005 payments		(0.3)	(0.3)
Balance as of September 30, 2005	$	$ 2.8	$ 2.8

On October 30, 2002, the Company announced that it would close its office in Andover, Massachusetts, which was primarily a product development and repair facility. The Company decided to close the office in order to reduce operating costs through consolidation of its facilities. The closure affected approximately 75 employees. In connection with these actions, the Company recorded a net charge of approximately $7.1 million in the fourth quarter of 2002. Included in this restructuring charge was approximately $2.2 million related to remaining lease payments, $2.7 million of fixed asset write-offs, $2.2 million of severance, and $0.5 million of other costs, net of a reduction of a bonus accrual related to the severed employees of $0.5 million. During the second quarter 2005, the Company satisfied the remaining lease payments. Below is a table that summarizes the activity in the restructuring reserve (in millions):

	Lease Commitments	Employee Severance	Other Costs	Total
Balance as of December 31, 2002	$ 2.2	$ 2.1	$ 0.5	$ 4.8

2003 payments	(1.2)	(1.9)		(3.1)
Adjustments to accrual		(0.2)	(0.5)	(0.7)
Balance as of December 31, 2003	1.0			1.0
2004 payments	(0.7)			(0.7)
Balance as of December 31, 2004	0.3			0.3
First quarter 2005 payments				
Balance as of March 31, 2005	0.3			0.3
Second quarter 2005 payments	(0.4)			(0.4)
Second quarter 2005 adjustments to accrual	0.1			0.1
Balance as of September 30, 2005	$	$	$	$

In the third quarter of 2001, the Company announced a restructuring plan to outsource the functions of most of its manufacturing facilities. This decision to reorganize was due in part to the ongoing weakness in industry spending patterns. Also during the third quarter of 2001, the Company reserved for lease commitments related to an excess facility in Atlanta. As a result of market conditions at that time, ARRIS had downsized and the facility was vacant. As of September 30, 2005, the remaining $0.7 million balance in the restructuring reserve related to lease terminations and other shutdown costs. The remaining costs are expected to be expended by the end of 2006 (end of lease). Below is a table that summarizes the activity in the accrual account (in millions):

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	Lease Commitments & Other Costs	Employee Severance	Total
Balance as of December 31, 2002	$ 2.0	$ 0.8	$ 2.8
2003 payments	(2.5)	(0.5)	(3.0)
2003 adjustments to accrual	5.0	(0.2)	4.8
Balance as of December 31, 2003	4.5	0.1	4.6
2004 payments	(3.1)		(3.1)
2004 adjustments to accrual	0.1	(0.1)	
Balance as of December 31, 2004	1.5		1.5
First quarter 2005 payments	(0.4)		(0.4)
First quarter 2005 adjustments to accrual.	0.1		0.1
Balance as of March 31, 2005	1.2		1.2
Second quarter 2005 payments	(0.1)		(0.1)
Second quarter 2005 adjustments to accrual	(0.1)		(0.1)
Balance as of June 30, 2005	1.0		1.0
Third quarter 2005 payments	(0.3)		(0.3)
Third quarter 2005 adjustments to accrual.	$ 0.7	$	$ 0.7

Note 9. Inventories

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

	September 30, 2005 (Unaudited)	December 31, 2004
Raw material	$ 876	$ 1,456
Finished goods	89,246	91,180
Total net inventories	$ 90,122	$ 92,636

Note 10. Property, Plant and Equipment

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

	September 30, 2005 (Unaudited)	December 31, 2004
Land	$ 1,822	$ 1,822
Building and leasehold improvements	11,145	11,828
Machinery and equipment	80,681	74,621

		93,648		88,271
Less: Accumulated depreciation		(67,165)		(61,146)
Total property, plant and equipment, net	$	26,483	$	27,125

Note 11. Goodwill and Intangible Assets

The Company s goodwill and indefinite lived intangible assets are reviewed annually for impairment or more frequently if impairment indicators arise. The annual valuation is performed during the fourth quarter of each year and is based upon management s analysis including an independent valuation. Separable intangible assets

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that are not deemed to have an indefinite life are amortized over their useful lives. Each of the Company s intangible assets has an amortization period of three years.

The carrying amount of goodwill for both the year ended December 31, 2004 and for the nine months ended September 30, 2005 was $150.6 million.

During the first quarter 2005, a decrease in expected future cash flows related to the Atoga product line indicated that the long-lived assets associated with these products may be impaired. As a result, the Company analyzed the fair value of those assets, using the expected cash flow approach, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The resulting analysis indicated that the remaining intangibles of $0.2 million were fully impaired and were written off in the first quarter 2005. There were no additional assets deemed to be impaired in the second and third quarters of 2005.

The gross carrying amount and accumulated amortization of the Company s intangible assets, other than goodwill, as of September 30, 2005 and December 31, 2004 are as follows (in thousands) :

	September 30, 2005				December 31, 2004		
	Gross Amount	Impairment	Accumulated Amortization	Net Book Value	Gross Amount	Accumulated Amortization	Net Book Value
Existing technology acquired:							
Arris Interactive L.L.C	$ 51,500	$	$ (51,500)	$	$ 51,500	$ (51,500)	$
Cadant, Inc.	53,000		(53,000)		53,000	(52,661)	339
Atoga Systems	689	(231)	(458)		689	(401)	288
Com21	1,929		(1,367)	562	1,929	(884)	1,045
cXm Broadband	691		(115)	576			
Total	$107,809	$(231)	$(106,440)	$1,138	$107,118	$(105,446)	$1,672

Amortization expense recorded on the intangible assets listed in the above table for the three and nine months ended September 30, 2005 was $0.2 million and $1.0 million, respectively, and compares to expense of $6.2 million and $24.1 million, respectively, for the same periods in 2004. The estimated remaining amortization expense for the next five fiscal years is as follows (in thousands):

2005	$ 218
2006	$ 632
2007	$ 230
2008	$ 58
2009	$

Note 12. Long-Term Obligations

Long-term debt and other long-term obligations consist of the following (in thousands):

	September 30, 2005 (unaudited)	December 31, 2004
4 1/2% convertible subordinated notes due 2008	$	$ 75,000

Other liabilities	16,683	16,781
Total long term debt and other long-term liabilities	$ 16,683	$ 91,781

On March 18, 2003, the Company issued $125.0 million of 4 1/2% convertible subordinated notes due 2008 (Notes). The Notes were convertible, at the option of the holder, at any time prior to maturity, into the Company s common stock at a conversion price of $5.00 per share, subject to adjustment. In February 2004, the Company called $50.0 million of the Notes for redemption, and the holders of the called Notes elected to convert those Notes into an aggregate of 10.0 million shares of common stock rather than have the Notes redeemed. The Company also made a make-whole interest payment of approximately 0.5 million common shares, resulting in a charge of $4.4 million during the first quarter of 2004. In May 2005, the Company called the remaining $75.0

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million of the Notes for redemption, and the holders of the Notes elected to convert the notes into 15.0 million shares of common stock rather than have the Notes redeemed. The Company made a make-whole interest payment of approximately 0.3 million shares, resulting in a charge of $2.4 million during the second quarter 2005. As of September 30, 2005, the Notes have been fully converted and the Company has no long-term debt.

As of September 30, 2005 and December 31, 2004, the Company had approximately $4.1 million and $4.0 million, respectively, outstanding under letters of credit, which are cash collateralized and classified as restricted cash on the Consolidated Balance Sheets.

As of September 30, 2005, the Company had approximately $16.7 million of other long-term liabilities, which included $11.0 million related to its accrued pension, $3.1 million related to its deferred compensation obligations, deferred rental expense of $2.5 million related to landlord funded leasehold improvements, and $0.1 million related to security deposits received. As of December 31, 2004, the Company had approximately $16.8 million of other long-term liabilities, which included $10.9 million related to its accrued pension, $3.0 million related to its deferred compensation obligations, $2.8 million related to landlord funded leasehold improvements, and $0.1 million related to security deposits received.

The Company has not paid cash dividends on its common stock since its inception. In 2002, to implement its shareholder rights plan, the Company s Board of Directors declared a dividend consisting of one right for each share of its common stock outstanding. Each right represents the right to purchase one one-thousandth of a share of its Series A Participating Preferred Stock and becomes exercisable only if a person or group acquires beneficial ownership of 15% or more of its common stock or announces a tender or exchange offer for 15% or more of its common stock or under other similar circumstances.

Note 13. Comprehensive Income (Loss)

Total comprehensive income (loss) represents the net change in stockholders equity during a period from sources other than transactions with stockholders. For ARRIS, the components of total comprehensive income (loss) include the unrealized gain (loss) on marketable securities, unrealized gain (loss) on derivative instruments qualifying for hedge accounting and foreign currency translation adjustments. The components of comprehensive income (loss) for the three and nine months ended September 30, 2005 and 2004 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	(unaudited)			
	2005	**2004**	**2005**	**2004**
Net income (loss)	$18,820	$(3,706)	$ 29,517	$ (27,790)
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities	137	(21)	269	220
Unrealized gain (loss) on derivative instruments	991		991	
Translation adjustment		1	(1)	(36)
Comprehensive income (loss)	$19,948	$(3,726)	$ 30,776	$ (27,606)

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Note 14. Sales Information

A significant portion of the Company s revenue is derived from sales to its top four customers: Comcast, Liberty Global, Cox Communications, Charter Communications and Time Warner. Sales to these customers for the three and nine month periods ended September 30, 2005 and 2004 are set forth below (in thousands):

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2005	**2004**	**2005**	**2004**
Comcast	$44,506	$21,436	$91,831	$85,437
% of sales	22.1%	16.7%	18.4%	23.7%
Cox Communications	$33,683	$31,561	$88,058	$83,360
% of sales	16.8%	24.6%	17.6%	23.1%
Liberty Global	$26,530	$19,500	$77,541	$55,426
% of sales	13.2%	15.2%	15.5%	15.4%
Time Warner	$16,232	$11,912	$49,924	$22,443
% of sales	8.1%	9.3%	10.0%	6.2%

No other customer provided more than 10% of total sales for the three or nine months ended September 30, 2005 or 2004.

The Company operates globally and offers products and services that are sold to cable system operators and telecommunications providers. The Company s products and services are focused in two product categories: Broadband and Supplies & Customer Premises Equipment (CPE). Consolidated revenue by principal product and service for the three and nine months ended September 30, 2005 and 2004 were as follows (in thousands):

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2005	**2004**	**2005**	**2004**
Broadband	$ 81,263	$ 71,530	$ 222,148	$ 222,462
Supplies and CPE	119,694	56,879	276,934	138,112
Total sales	$ 200,957	$ 128,409	$ 499,082	$ 360,574

ARRIS sells its products primarily in North America. The Company s international revenue is generated from Asia Pacific, Europe, Latin America and Canada. The Asia Pacific market primarily includes China, Hong Kong, Japan, Korea, Singapore, and Taiwan. The European market primarily includes Austria, Belgium, France, Germany, the Netherlands, Poland, Portugal, Spain, and Switzerland. The Latin American market primarily includes Argentina, Chile, Brazil, and Puerto Rico. Sales to international customers were approximately $52.4 million, or 26.0% of total sales and $132.3 million, or 26.5% of total sales for the three and nine months ended September 30, 2005. International sales during the same periods in 2004 were $29.5 million, or 23.0% of total sales and $81.4 million, or 22.6% of total sales.

As of September 30, 2005, ARRIS held approximately $2.3 million of assets in Ireland, comprised of $1.2 million of cash and $1.1 million of fixed assets. As of December 31, 2004, ARRIS held approximately $2.1 million of assets in Ireland, comprised of $1.3 million of cash and $0.8 million of fixed assets.

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Note 15. Earnings Per Share

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

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Basic:				
Income (loss) from continuing operations	$ 18,850	$ (3,748)	$ 29,461	$ (29,003)
Income (loss) from discontinued operations	(30)	42	56	1,213
Net income (loss)	$ 18,820	$ (3,706)	$ 29,517	$ (27,790)
Weighted average shares outstanding	104,434	87,347	93,768	84,440
Basic earnings (loss) per share	$ 0.18	$ (0.04)	$ 0.31	$ (0.33)
Diluted:				
Income (loss) from continuing operations	$ 18,850	$ (3,748)	$ 29,461	$ (29,003)
Income (loss) from discontinued operations	(30)	42	56	1,213
Net income (loss)	$ 18,820	$ (3,706)	$ 29,517	$ (27,790)
Weighted average shares outstanding	104,434	87,347	93,768	84,440
Net effect of dilutive equity awards	2,615		1,600	
Total	107,049	87,347	95,368	84,440
Diluted earnings (loss) per share	$ 0.18	$ (0.04)	$ 0.31	$ (0.33)

The Notes were antidilutive for all periods presented. The effects of the options and warrants were not presented for the three and nine month periods ended September 30, 2004 as the Company incurred a net loss during that period and inclusion of these securities would have been antidilutive.

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Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Our long-term goal is to continue to increase our leading position as a worldwide provider of broadband access products and services. Our primary market and focus is cable providers or MSOs. To achieve this goal, we have implemented a long-term business strategy that includes the following key elements:

Transition to VoIP with an Everything IP, Everywhere philosophy and build on current market successes;

Leverage our current voice and data business;

Strengthen and grow our supplies infrastructure distribution channel;

Expand our existing product/services portfolio through internal developments, partnerships and acquisitions; and

Maintain and improve an already strong capital structure and expense structure.

Below is a summary of key year-to-date events, accomplishments and actions relative to these strategies:

Transition to VoIP with an Everything IP, Everywhere philosophy and build on current market successes

MSOs continued to aggressively deploy VoIP and, as a result, sales of embedded multimedia terminal adapters (E-MTA) increased significantly quarter over quarter. In the third quarter 2005, we sold over 863,000 E-MTAs as compared to 567,000 in the second quarter 2005 and 174,000 in the third quarter 2004. We anticipate that demand for this product will decline somewhat in the fourth quarter 2005 as our increased capacity shortens our lead time to supply our customers, and as our customers adjust their initial inventory levels to take advantage of this shortened lead time and to reduce inventories and match their deployment rates. We anticipate that we will continue to sell robust quantities of E-MTAs for the foreseeable future.

CableLabs selected the packet bonding approach to high-speed wideband data service envisioned in DOCSIS 3.0. ARRIS has been a proponent of this approach over other alternatives. We believe this positions us well for the evolution of our products.

We diversified our customer base through the first nine months of 2005 adding new customers to our client portfolio, and we significantly increased sales to existing major MSOs in our client base, most notably Charter and Time Warner.

Leverage our current voice and data business

In the first quarter 2005, we granted price reductions to our customers of constant bit rate (CBR) telephony products in order to extend the life of this product. Sales of this product have been robust, and we anticipate that they will continue into 2006 at a rate similar to that we have historically experienced. Ultimately, sales of these products will decline as customers move to VoIP for telephony services. We now anticipate the revenue will begin to decline in late 2006.

Expand our existing product/services portfolio through internal developments, partnerships and acquisitions

In the third quarter we spent $16.0 million on research and development. Through the first nine months of 2005, we spent approximately $45.1 million on research and development. Key accomplishments included:

- Ø The introduction of next generation E-MTAs, including cost reduced versions.
- Ø The 500-series Touchstone E-MTAs achieved both DOCSIS and EuroDOCSIS 2.0 certification.
- Ø The introduction of cost reductions within the CMTS product family.
- Ø

Continued work on our Keystone D5 Digital Multimedia Termination System product, which is expected to be commercially available in the first half of 2006. This new product has recently

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undergone interoperability testing with several video on demand systems and is currently in trial with customers.

Ø The Cadant C4 achieved Euro-DOCSIS 2.0 certification.

Ø Continued work on a multi-line E-MTA for use by our customers in multi-dwelling units (MDU) and businesses. We expect to launch this product in the first quarter of 2006.

Ø Continued work on a session initiated protocol (SIP) based version of our E-MTA for Eastern European and Asian customers. We expect to launch this product in the fourth quarter of 2005.

Maintain and improve an already strong capital structure and expense structure

Through the first nine months of 2005, we generated approximately $44.5 million from our net income, after adjustments for non-cash items. In the same period, we used approximately $39.5 million to fund higher accounts receivable levels resulting from our increased sales.

We called for redemption the balance of our 2008 Notes in the second quarter 2005. All holders of the Notes chose to convert their holdings into shares resulting in the issuance of 15.3 million shares. We now have no long term debt.

Our inventory and accounts receivable performance continues to be strong, with DSOs of 42 days and inventory turns of 6.8 in the third quarter 2005.

Significant Customers

A significant portion of the Company s revenue is derived from sales to its top customers: Comcast, Liberty Global, Cox Communications, and Time Warner were all 10% customers in both the third quarter and year to date 2005. Sales to these customers for the three and nine month periods ended September 30, 2005 and 2004 are set forth below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30, (unaudited)	
	2005	**2004**	**2005**	**2004**
Comcast	$ 44,506	$ 21,436	$ 91,831	$ 85,437
% of sales	22.1%	16.7%	18.4%	23.7%
Cox Communications	$ 33,683	$ 31,561	$ 88,058	$ 83,360
% of sales	16.8%	24.6%	17.6%	23.1%
Liberty Global	$ 26,530	$ 19,500	$ 77,541	$ 55,426
% of sales	13.2%	15.2%	15.5%	15.4%
Time Warner	$ 16,232	$ 11,912	$ 49,924	$ 22,443
% of sales	8.1%	9.3%	10.0%	6.2%

No other customer provided more than 10% of total sales for the three or nine months ended September 30, 2005 or 2004.

Backlog

Our backlog consists of unfilled customer orders believed to be firm and long-term contracts that have not been completed. With respect to long-term contracts, we include in our backlog only amounts representing orders currently released for production or, in specific instances, the amount we expect to be released in the succeeding 12 months. The amount contained in backlog for any contract or order may not be the total amount of the contract or order. The

amount of our backlog at any given time does not reflect expected revenues for any fiscal period. Our backlog at September 30, 2005 was approximately $171.2 million, and at September 30, 2004 was approximately $64.7 million.

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Comparison of Operations for the Three and Nine Months Ended September 30, 2005 and 2004

Net Sales

The table below sets forth our net sales for the three and nine months ended September 30, 2005 and 2004, for each of our product categories (in millions):

	Net Sales				Increase (Decrease) Between 2005 and 2004			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2005	2004	2005	2004	$	%	$	%
Product Category:								
Broadband	$ 81.3	$ 71.5	$ 222.2	$ 222.5	$ 9.8	14%	$ (0.3)	(0.1%)
Supplies & CPE	119.7	56.9	276.9	138.1	62.8	110%	138.8	101%
Total sales	$ 201.0	$ 128.4	$ 499.1	$ 360.6	$ 72.6	57%	$ 138.5	38%

The table below sets forth our domestic and international sales for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Net Sales				Increase (Decrease) Between 2005 and 2004			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2005	2004	2005	2004	$	%	$	%
Domestic	$ 148.6	$ 98.9	$ 366.8	$ 279.2	$ 49.7	50%	$ 87.6	31%
International	52.4	29.5	132.3	81.4	22.9	78%	50.9	63%
Total sales	$ 201.0	$ 128.4	$ 499.1	$ 360.6	$ 72.6	57%	$ 138.5	38%

Broadband Net Sales 2005 vs. 2004

During the three months ended September 30, 2005, sales of our Broadband products increased by approximately 14%. Sales of our Broadband product for the first nine months of 2005 were consistent with the same period in 2004. Sales within this product category reflect:

As anticipated, sales of our CBR voice products in the first nine months of 2005 declined from 2004. However, we continued to have robust sales of CBR product to Cox Communications and J: COM. We believe that the sales of these products will decline in 2006 as our customers transition to VoIP. Further, in the first half of 2005, we provided price reductions to customers to extend the life of the product.

Sales of our CMTS products for the first nine months of 2005 increased from the same period in 2004, offsetting the decrease in CBR product sales.

Supplies & CPE Net Sales 2005 vs. 2004

Supplies & CPE product revenue increased by approximately 110% and 101% in the three and nine month periods ended September 30, 2005, as compared to the same periods in 2004. These increases reflect:

Increased sales of our E-MTA product provided the majority of the increase as operators ramped deployment of VoIP. In the three and nine months ended September 30, 2005, we sold 863,000 and 1,764,000 E-MTAs, as

compared to approximately 174,000 and 214,000 units during the same periods in 2004.

Supplies & CPE product revenue internationally increased in 2005 as compared 2004, primarily due to an increase in sales of cable modems and E-MTAs to our international customers.

We anticipate a decline in E-MTA sales in the fourth quarter 2005 as our supply has caught up to demand, and customers adjust their inventory levels to better match their deployment rates.

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Gross Margin

The table below sets forth our gross margin for the three and nine months ended September 30, 2005 and 2004, for each of our product categories (in millions):

	Gross Margin $				Increase (Decrease) Between 2005 and 2004			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2005	2004	2005	2004	$	%	$	%
Product Category:								
Broadband	$ 28.4	$ 29.7	$ 81.9	$ 93.8	$ (1.3)	(4%)	$ (11.9)	(13%)
Supplies & CPE	26.6	6.0	51.0	18.6	20.6	343%	32.4	174%
Total	$ 55.0	$ 35.7	$ 132.9	$ 112.4	$ 19.3	54%	$ 20.5	18%

The table below sets forth our gross margin percentages for the three and nine months ended September 30, 2005 and 2004, for each of our product categories:

	Gross Margin %				Increase (Decrease) Between 2005 and 2004	
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Three Months Ended September 30	For the Nine Months Ended September 30
	2005	2004	2005	2004	Percentage Points	
Product Category:						
Broadband	34.9%	41.5%	36.8%	42.2%	(6.6)	(5.4)
Supplies & CPE	22.2%	10.6%	18.4%	13.5%	11.6	4.9
Total	27.4%	27.8%	26.6%	31.2%	(0.4)	(4.6)

Broadband Gross Margin 2005 vs. 2004

The decrease in Broadband gross margin dollars and percentages related primarily to the following factors:

Price reductions were provided to customers for our CBR product line in the first half of 2005, lowering the margin percentage for this product year over year.

In the second half of 2004, our next generation DOCSIS 2.0 CMTS was introduced. The initial margin percentages for this product were lower than historical margins due to higher initial product costs. Cost reduction programs are ongoing and a portion of them were implemented in early 2005; however, the margin percentages were lower year-over-year for the reasons stated above.

In the third quarter of 2005, we recorded approximately $2.4 million of inventory reserves related to our first generation CMTS product, specifically the older C4 1Dx8U blades. We have some inventory remaining that we are attempting to sell. In the third quarter 2005, we lowered our pricing on these older products to what we believe are competitive levels in order to deplete our inventory. As a result, we wrote our inventory down to its estimated net realizable value, negatively impacting margins.

Supplies & CPE Gross Margin 2005 vs. 2004

The Supplies & CPE category gross margin dollars and percentage increased year-over-year. The following factors impacted gross margin in 2005 as compared to 2004:

The increase in revenues year-over-year significantly impacted gross margin dollars. This was predominantly related to our increase in sales of E-MTAs.

In the third and fourth quarters of 2004, our Supplies & CPE gross margin percentages were 10.6% and 13.4%, respectively. Cost reduction programs related to E-MTAs were implemented in the first three quarters of 2005, which improved our margins. As a result of higher than expected demand in the second quarter 2005, we incurred higher transportation costs as we shipped E-MTAs by air in order to meet our customers requirements, which depressed margins. During the third quarter 2005, we returned

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to shipping primarily via ocean freight. That coupled with the impact of our cost reduction programs led to the improvement quarter over quarter in margin percentage.

Future margins for our Supplies & CPE product will be dependent upon the impact of, among other factors, achievement of planned cost reductions, product mix, and competitive price actions.

Our overall gross margin percent is dependent upon a number of factors including, but not limited to:

The impact of product mix, in particular the impact of selling more, lower margin E-MTAs, particularly given the increase in demand we have experienced.

Changes in the product life cycle for our products, in the near term particularly our CBR products

Many of our products are susceptible to technological obsolescence and / or changes in our customers spending patterns. As a result, from time to time, we may adjust our pricing in an effort to better position our products within the market. These sales may be below historic margins. To the extent that we conclude that such items cannot be sold at or above their cost, we record an inventory reserve through a current charge to cost of sales as we value these items at their net realizable value. When this occurs, margins are negatively impacted.

Operating Expenses

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

	Operating Expenses				Increase (Decrease) Between 2005 and 2004			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2005	2004	2005	2004	$	%	$	%
SG&A	$ 19.9	$ 17.1	$ 54.1	$ 53.2	$ 2.8	16%	$ 0.9	2%
Provision for doubtful accounts	0.2	0.6	(0.3)	0.9	(0.4)	(67)%	(1.2)	(133)%
Research & development	16.0	14.8	45.1	47.3	1.2	8%	(2.2)	(5)%
Restructuring & impairment		0.1	0.4	7.1	(0.1)	(100)%	(6.7)	(94)%
Amortization of intangibles	0.2	6.2	1.0	24.1	(6.0)	(97)%	(23.1)	(96)%
Total	$ 36.3	$ 38.8	$ 100.3	$ 132.6	$ (2.5)	(6)%	$ (32.3)	(24)%

Selling, General, and Administrative, or SG&A, Expenses and Provision for Doubtful Accounts

Over the past several years, we have aggressively managed our operating expenses, including the implementation of cost reduction actions. We continue to have a strong focus on maintaining our operating cost structure, and regularly examine other actions that may need to be taken to reduce the cost structure of the business.

The net increase in expenses both quarter over quarter and through the first nine months are the result of key factors:

Given our strong business performance relative to both 2004 and to targets established by our Board of Directors, it is anticipated that variable compensation payments for 2005 (commissions and bonuses) will be greater than earlier estimates for 2005 and as compared to 2004. As a result, compensation expense increased.

As explained elsewhere, we adopted SFAS No. 123R in the third quarter 2005. This resulted in higher non-cash compensation expense both quarter over quarter and for the first nine months.

Our bad debt expense has decreased both quarter over quarter and for the first nine months reflecting our strong collections and our low write-off experience in 2005.

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Research & Development (R&D) Expenses

We continue to aggressively invest in research and development. Our primary focus is on products that allow MSOs to capture new revenues, in particular, high-speed data, VoIP, and Video over IP; however, we also continue to place emphasis on reducing product costs and test equipment costs.

The increase in our R&D expenses for the three month period in 2005 as compared to 2004 is the result of:

Increase in compensation expense related to variable compensation payments for 2005 (bonuses) described above.

Increase in compensation expense related to the adoption of SFAS No. 123R.

Although the quarter over quarter R&D expenses increased in 2005, the total R&D expenditures decreased for the nine month period ended September 30, 2005 as compared to the same period in 2004. The increases noted above were offset by the following decreases;

Included in the second quarter 2005 expenses was a benefit of approximately $1.2 million representing funding received from a customer related to development work that ARRIS performed for it over the past 18 months. The expense incurred to perform the work was charged to research and development in the periods it was performed. The customer provided progress payments over the time period. The payments were recorded as a liability until the work was completed and no contingency existed for the potential of the return of the payments to the customer. This occurred in the second quarter 2005, at which time the payments were recognized as an offset to research and development expense.

In 2005, we decreased our research and development investments in the Atoga product line.

Restructuring and Impairment Charges

On a quarterly basis, we review our existing restructuring accruals and make adjustments if necessary. As a result of these evaluations, we recorded an increase to a restructuring accrual of $34 thousand during the third quarter 2005, resulting in restructuring expense. During the third quarter 2004, we recorded additional restructuring charges of approximately $56 thousand related to previously closed facilities. These adjustments were required due to a change to the initial estimates used. See Note 8 of Notes to the Consolidated Financial Statements.

During the first quarter 2005, indications of impairment related to the long-lived assets associated with our Atoga products arose. As a result, we analyzed the fair value of those assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The resulting analysis indicated that the remaining intangibles of $0.2 million were fully impaired and were written off during the quarter.

During the first quarter of 2004, ARRIS consolidated two facilities in Georgia, giving the Company the ability to house many of its core technology, marketing, and headquarters functions in a single building. This consolidation resulted in a restructuring charge of $6.2 million in the first quarter of 2004 related to lease commitments and the write-off of leasehold improvements.

Amortization of Intangibles

Intangibles amortization expense for the three and nine months ended September 30, 2005 was $0.2 million and $1.0 million, respectively, and compares to expense of $6.2 million and $24.1 million, respectively, for the same periods in 2004. Our intangible assets represent existing technology acquired as a result of the Arris Interactive L.L.C. acquisition in the third quarter 2001, the Cadant, Inc. acquisition in the first quarter 2002, the Atoga Systems acquisition in the first quarter 2003, the Com21 product line acquisition in the third quarter 2003, and the cXm Broadband acquisition in the second quarter 2005. The intangible assets that are not fully amortized as

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of September 30, 2005, are the existing technologies acquired from Com21 and cXm Broadband. See Note 11 of Notes to Consolidated Financial Statements.

Other Expense (Income):

Interest Expense

Interest expense for the three and nine months ended September 30, 2005 was $0.0 million and $2.0 million, respectively, and compares to interest expense of $1.0 million and $3.7 million for the three and nine months ended September 30, 2004, respectively. Interest expense reflects the amortization of deferred finance fees and the interest paid on the Notes. During the second quarter 2005, the remaining balance of $75.0 million of Notes was converted, thus eliminating our interest expense in the third quarter of 2005.

Loss on Debt Retirement

In February 2004, we called $50.0 million of the Notes due 2008 for redemption, and holders of the called notes elected to convert their notes into an aggregate of 10.0 million shares of common stock, rather than have the notes redeemed. Under the indenture s terms for redemptions prior to March 18, 2006, we made a make-whole interest payment of approximately 0.5 million common shares, resulting in a charge of $4.4 million during the three months ended March 31, 2004.

In May 2005, the Company called the remaining $75 million of the Notes for redemption and the holders of the Notes elected to convert the notes into 15.0 million shares of common stock rather than have the Notes redeemed. The Company made a make-whole interest payment of approximately 0.3 million shares resulting in a charge of $2.4 million during the second quarter 2005. As of June 30, 2005, the Notes have been fully converted and the Company has no long term debt.

Loss (Gain) on Investments

We hold certain investments in the common stock of publicly-traded companies and also hold a number of non-marketable equity securities. For further discussion on the classification and the accounting treatment of these investments, see the Investments section within Financial Liquidity and Capital Resources. During the three and nine months ended September 30, 2005, we recognized gains on investments of $0.1 million and $0.1 million, respectively. During the same periods in 2004, we had losses of $0.2 million and $1.6 million.

Equity in Losses of Unconsolidated Affiliate

At the end of 2004, ARRIS held a non-marketable equity security of $0.6 million and a short-term note receivable of $0.5 million from a private company named coaXmedia. On January 31, 2005, we foreclosed on the note receivable. This was a joint proceeding with the other major note holder of the private company. A new L.L.C. was formed, named cXm Broadband, with the other major note holder, of which ARRIS held a 25% interest. For two months of the first quarter 2005, ARRIS accounted for the investment in the new L.L.C. using the equity method of accounting. ARRIS proportionate amount of the first quarter 2005 losses of the new L.L.C. was $75,000.

In March 2005, ARRIS and the other note holder agreed to ARRIS acquisition of the other note holder s interest in cXm Broadband. This transaction closed on April 1, 2005 and the product line was integrated into ARRIS in the second quarter 2005. See Note 7 of Notes to the Consolidated Financial Statements for further discussion.

Loss (Gain) in Foreign Currency

The purpose of our foreign currency hedging activities is to reduce the risk that our eventual US dollar net cash inflows resulting from euro denominated sales outside the United States will be adversely affected by changes in exchange rates.

We enter into forward exchange contracts and purchase currency options (principally Euro) and collars to hedge certain portions of forecasted sales and the resulting cash flows denominated in foreign currencies. The effective portion of the changes in fair value for these contracts, which have been designated as cash flow hedges, are reported in other comprehensive income and reclassified into earnings in the same financial statement line item

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and in the same period or periods during which the hedged transaction affects earnings. Any ineffective or non-designated portion (which represented all the hedging activity prior to the third quarter of 2005) of the change in fair value of these instruments is immediately recognized in earnings. As of September 30, 2005, the outstanding contracts mature with in one year.

ARRIS uses derivative financial instruments to reduce our exposure to adverse fluctuations in foreign exchange rates, specifically the Euro to the US dollar. When entered into, we formally designate and document the financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for undertaking the hedge transactions.

ARRIS recognizes all derivative instruments as either assets or liabilities in our consolidated balance sheet at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship, and, further, on the type of hedging relationship. At the inception of the hedging relationship, we must designate the instrument as a fair value hedge, a cash flow hedge, or a hedge of a net investment in a foreign operation. This designation is based upon the exposure being hedged. Currently all derivative instruments on our balance sheet have been designated as cash flow hedges.

In the third quarter 2005, we entered into a series of foreign exchange derivative contracts which we designated as cash flow hedges to hedge forecasted euro denominated sales. These contracts total 39.2 million euros and expire in various increments monthly beginning November 2005 and ending September 2006. As these contracts qualify for hedge accounting, we are applying the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* to account for them. If at anytime the likelihood of a hedged forecasted transaction is no longer probable, hedged accounting under SFAS No. 133 will cease on a prospective basis and all future changes in the fair value of the derivative will be recognized in earnings. As of September 30, 2005 we have recorded an unrealized gain of $1.0 million in other comprehensive income.

Additionally, we enter into forward exchange contracts that are not designated as hedging instruments under SFAS No. 133. Changes in the fair value of these instruments are immediately recognized in earnings in the line item other income (loss). As of September 30, 2005, these contracts totaled 7.5 million euros and expire in December 2005.

Our overall foreign currency loss (gain) includes the effect of the fluctuation of our foreign currency cash and receivables balances and derivative contracts. The loss (gain) in foreign currency also reflects the losses (gains) associated with the ineffective derivative contracts we have outstanding**.** The loss (gain) in foreign currency for the three and nine months ended September 30, 2005 was approximately $0.3 million and $0.1 million, respectively. During the three and nine months ended September 30, 2004, the loss (gain) in foreign currency was approximately $(0.2) million and $(0.1) million, respectively.

Other Expense (Income)

Other expense (income) for the three and nine months ended September 30, 2005 was $(0.7) million and $(1.7) million, respectively. During the same periods in 2004, the other expense (income) was approximately $(0.3) million and $(0.8) million, respectively. The other income recorded during all periods was primarily interest income.

Income Tax Expense (Benefit)

During the three and nine months ended September 30, 2005, we recorded income tax expense (benefit) of $0.3 million and $0.2 million, comprised of a provision for alternative minimum tax (AMT) and foreign tax liability, offset by state income tax refunds and a partial reduction of an income tax reserve. ARRIS has net operating losses (NOLs) that are used to offset current earnings and reduce our current regular tax liability to zero. For AMT purposes, only 90% of AMT income can be offset with AMT NOLs. The remaining 10% of AMT income is taxed at the AMT rate of 20%.

For the three and nine months ended September 30, 2004, we recorded income tax expense of $38,000 and $84,000 related to foreign tax liabilities.

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Discontinued Operations

During the three and nine months ended September 30, 2005, the Company recorded expense (income) of $30,000 and ($56,000) related to its reserves for discontinued operations. These adjustments were the result of the resolution of various vendor liabilities and other costs. As of September 30, 2005, the balance of the accrual was approximately $37,000, which relates to severance and other miscellaneous costs. During the three and nine months ended September 30, 2004, we recognized income of $0.0 million and $1.2 million in discontinued operations. Included in the first half 2004 income was a partial recovery with respect to amounts previously written off associated with an Argentinean customer. Of this total gain of $0.9 million, approximately $0.3 million related to discontinued products and was recorded in discontinued operations. The remaining discontinued operations income in 2004 was the result of accrual adjustments due to changes in estimates.

Financial Liquidity and Capital Resources

Overview

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

Liquidity & Capital Resources Data

	Nine Months Ended September 30,	
	2005	**2004**
	(in millions, except DSO and turns)	
Key Working Capital Items		
Cash provided by (used in) operating activities	$ (9.1)	$ 12.4
Cash, cash equivalents, and short-term investments	$ 94.4	$ 95.9
Accounts Receivable, net	$ 95.8	$ 64.5
Days Sales Outstanding (DSOs)	42	46
Inventory	$ 90.1	$ 88.3
Inventory turns	5.3	4.0

In managing our liquidity and capital structure, below is a description of key actions and goals implemented:

Inventory & Accounts Receivable Programs

We place a strong emphasis on working capital management, particularly with respect to accounts receivable and inventory. We use turns to evaluate inventory management and days sales outstanding, or DSOs, to evaluate accounts receivable management. As the table above indicates, we have improved our performance, particularly as evidenced by the year-to-date 2005 turns of 5.3 and DSOs of 42 days.

Looking forward, we do not anticipate a significant reduction in DSOs. It is possible that DSOs may increase, particularly if the international content of our business increases as international customers typically have longer payment terms.

Full Redemption of the 2008 Notes

In February 2004, our stock price had risen to the levels required under the indenture where we were entitled to redeem, in full or in part, the Notes due 2008. At that time, we gave notice of a partial redemption of $50.0 million (with a make whole payment, described elsewhere, to be paid in stock). All redeemed note holders chose to convert their notes into stock, resulting in the issuance of 10.0 million shares of ARRIS common stock.

In May 2005, our stock price had risen to the levels required under the indenture where we were entitled to redeem, in full or in part, the balance of the Notes. The Company called the remaining $75.0 million of the Notes for redemption and the holders of the Notes elected to convert the notes into 15.0 million shares of common stock

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rather than have the Notes redeemed. The Company made a make-whole interest payment of approximately 0.3 million shares resulting in a charge of $2.4 million during the second quarter 2005.

Summary of Current Liquidity Position and Potential for Future Capital Raising

We believe our current liquidity position, including approximately $94 million of cash, cash equivalents and short-term investments on hand as of September 30, 2005, together with the prospects for continued generation of cash from operations are adequate for our short- and medium-term business needs. However, a key part of our overall long-term strategy may be implemented through additional acquisitions. Either in order to be prepared to make acquisitions generally or in connection with particular acquisitions, it is possible that we will raise capital through private, or public, share or debt offerings. We believe we have the ability to access the capital markets upon commercially reasonable terms.

Commitments

In the ordinary course of business, from time to time, we will request our contract manufacturers to place orders with their vendors to secure supply of long lead time parts beyond the timeframe that our purchase orders cover. In certain instances, we provide our contract manufacturers with a commitment to purchase from them any excess parts should we not consume them in the ordinary course as we purchase product from them. These commitments are included within our contractual obligations that are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2004. There has been no material change to our contractual obligations during the first nine months of 2005 other than the retirement of $75.0 million of long-term debt.

Cash Flow

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

	For the Nine Months Ended September 30,	
	2005	2004
Cash provided by (used in) operating activities	$ (9.1)	$ 12.4
Cash provided by (used in) investing	$ 23.9	$ (57.2)
Cash provided by (used in) financing	$ 8.3	$ 5.8
Net increase (decrease) in cash	$ 23.1	$ (39.0)

Operating Activities:

Below are the key line items affecting cash from operating activities (in millions):

	For the Nine Months Ended September 30,	
	2005	2004
Net income (loss) after non-cash adjustments	$ 44.5	$ 12.7
(Increase)/Decrease in accounts receivable	(39.5)	(9.1)
(Increase)/Decrease in inventory	2.8	(9.7)
All other net	(16.9)	18.5
Cash provided (used in) operating activities	$ (9.1)	$ 12.4

We generated significant cash flow from net income, after non-cash adjustments, in the first nine months of 2005 as a result of our higher revenues.

We generated $2.8 million of cash related to a decrease in our inventory levels over the first nine months of 2005.

We used $39.5 million of cash in the first nine months of 2005 as a result of an increase in our accounts receivable due to our increased sales. We continue to enjoy strong DSO performance. Our year-to-date 2005 DSO was 42 days as compared to our year-to-date 2004 DSO of 46 days.

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Investing Activities:

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

	For the Nine Months Ended September 30,	
	2005	2004
Capital expenditures	$ (7.6)	$ (7.2)
Purchases of short-term investments	(51.3)	(89.8)
Disposals of short-term investments	83.0	39.8
Other	(0.2)	(0.0)
Cash provided by (used in) investing activities	$ 23.9	$ (57.2)

Capital Expenditures

Capital expenditures are mainly for test equipment and computing equipment. We anticipate investing approximately $10.0 million to $12.0 million in fiscal year 2005.

Purchases/Disposals of Short-Term Investments

This primarily represents purchases and disposals of auction rate securities held as short-term investments.

Other

This primarily represents cash investments we have made in cXm Broadband, a private company.

Financing Activities:

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

	For the Nine Months Ended September 30,	
	2005	2004
Payments on debt obligations	$	$ (1.2)
Proceeds from issuance of stock	8.3	7.0
Cash provided by (used in) financing activities	$ 8.3	$ 5.8

Cash provided from financing activities for both periods presented is primarily related to the exercise of stock options by employees.

Interest Rates

As of September 30, 2005, we did not have any floating rate indebtedness and we did not have any outstanding interest rate swap agreements.

Foreign Currency

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

We have certain international customers who are billed in their local currency. We use a hedging strategy and enter into forward or currency option contracts based on a percentage of expected foreign currency receipts. The percentage can vary, based on the predictability of cash receipts. We routinely review our accounts receivable in foreign currency and periodically initiate forward or option contracts when appropriate.

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Financial Instruments

In the ordinary course of business, we, from time to time, will enter into financing arrangements, such as letters of credit, with customers. 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. As of September 30, 2005 and December 31, 2004, we had approximately $4.1 million outstanding at the end of each period under letters of credit that were cash collateralized. The cash collateral is reported as restricted cash.

Short-Term Investments

We held short-term investments consisting of debt securities classified as available-for-sale, which are stated at estimated fair value. These debt securities included U.S. treasury notes, state and municipal bonds, asset-backed securities, auction rate securities, corporate bonds, commercial paper, and certificates of deposit. These investments were on deposit with a major financial institution. As of September 30, 2005 and December 31, 2004 the fair market value of these investments was $46.3 million and $78.0 million, respectively.

Investments

We hold certain investments in the common stock of publicly-traded companies which are classified as available for sale. Changes in the market value of these securities are typically recorded in other comprehensive income. These securities are also subject to a periodic impairment review, which requires significant judgment. Because these investments had been below their cost basis for a period greater than six months, impairment charges of approximately $0.6 million and $1.4 million were recorded during the three and nine months ended September 30, 2004, respectively. As of September 30, 2005 and December 31, 2004, the carrying value of these investments was $0.

In addition, we hold a number of non-marketable equity securities totaling approximately $0.2 million and $0.8 million at September 30, 2005 and December 31, 2004, respectively, which are classified as available for sale. The non-marketable equity securities are subject to a periodic impairment review, which requires significant judgment as there are no open-market valuations.

As of December 31, 2004, ARRIS held a non-marketable equity security of $0.6 million (included in the total of $0.8 million described above) and a short-term note receivable of $0.5 million from a private company named coaXmedia. Late in 2004, coaXmedia was unsuccessful in attempts to raise additional funds to finance its business. On January 31, 2005, we foreclosed on the note receivable and reclassified the note receivable to our investment in the company. This was a joint proceeding with the other major note holder of the private company. A new L.L.C. was formed, named cXm Broadband, with the other major note holder, of which ARRIS held a 25% interest. In March 2005, ARRIS and the other note holder agreed to ARRIS acquisition of the other note holder s interest in the L.L.C. This transaction closed in April 2005 and the product line was integrated into ARRIS in the second quarter 2005. The balance of the investment was considered as part of the purchase price of cXm Broadband. See Note 7 of Consolidated Notes to the Financial Statements for further discussion.

We previously provided a deferred compensation arrangement that allowed certain employees to defer a portion of their earnings and defer the related income taxes. As of December 31, 2004, the plan was frozen and no further contributions are allowed. The deferred earnings were invested in a rabbi trust, and are accounted for in accordance with Emerging Issues Task Force Issue No. 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested*. A rabbi trust is a funding vehicle used to protect deferred compensation benefits from various events (but not from bankruptcy or insolvency). At September 30, 2005, ARRIS had an accumulated unrealized gain related to the rabbi trust of approximately $1.0 million included in other comprehensive income.

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Capital Expenditures

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS capital expenditures were $7.6 million during the first nine months of 2005 as compared to $7.2 million during the same period in 2004. ARRIS had no significant commitments for capital expenditures at September 30, 2005. Management expects to invest approximately $10.0 million to $12.0 million in capital expenditures for the fiscal year 2005.

Critical Accounting Estimates

The accounting and financial reporting policies of the Company are in conformity with U.S. generally accepted accounting principles. The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. A description of our critical accounting policies and estimates are disclosed in our Form 10-K for the year ended December 31, 2004, as filed with the United States Securities and Exchange Commission.

Adoption of SFAS No. 123R, *Share-Based Payment*

We elected to early adopt the fair value recognition provisions of SFAS No. 123R on July 1, 2005, using the modified prospective approach. Prior to the adoption date, we used the intrinsic value method for valuing our awards of stock options and restricted stock and recorded the related compensation expense, if any, in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations. Prior to the adoption of SFAS No. 123R, the Company recognized stock award forfeitures as they occurred. In accordance with SFAS No. 123R, ARRIS has changed its accounting policy as of July 1, 2005 from the actual forfeiture method to an estimate of expected forfeitures in calculating the compensation expense. The cumulative effect of this change in accounting principle was immaterial. With the exception of variable stock option expense discussed below, no other stock-based employee or director compensation cost for stock options was reflected in net income (loss) prior to July 1, 2005, as all options granted had exercise prices equal to the market value of the underlying common stock on the date of grant. We record compensation expense related to our restricted stock awards and director stock units.

Stock Options

We grant stock options to certain employees that are settled in stock. Stock options generally vest over three or four years of service and have either seven or ten year contractual terms. The exercise price of an option is equal to the fair market value of ARRIS stock on the date of grant. The fair value of an option is estimated on the date of grant using the Black-Scholes option valuation model. Upon adoption of SFAS No. 123R, we engaged an independent third party to assist us in determining the Black-Scholes weighted average assumptions utilized in the valuation of options granted subsequent to July 1, 2005. The expected term of the awards granted are based upon a weighted average life of historical exercise activity of the grantee population. The volatility factors are based upon a combination of historical volatility from January 1, 2003, and estimates of implied volatility based on traded option contracts on ARRIS common stock. The risk-free interest rate is based upon the U.S. treasury strip yield at the grant date, using a remaining term equal to the expected life. The expected dividend yield is 0%, as we have not paid cash dividends on our common stock since our inception.

In May 2005, the ARRIS Board of Directors approved the acceleration of outstanding options with exercise prices equal to $9.06 and above. All of these options were out-of-the-money at the time of acceleration, as the closing stock price on May 5, 2005 was $7.67. The acceleration covered options to purchase approximately 1.4 million shares of common stock, but did not involve any options held by directors or executive officers. The purpose of the acceleration was to reduce the expense that would be associated with these options in accordance with the provisions of SFAS No. 123R, *Share-Based Payment,* once adopted. The acceleration resulted in incremental stock-based employee compensation of approximately $5.7 million in the pro forma expense for the second quarter 2005.

Restricted Stock (Non-Performance) and Stock Units

We grant restricted stock and stock units to certain employees and our outside directors. We record a fixed compensation expense equal to the fair market value of the shares of restricted stock granted on a straight-line basis over the requisite services period for the restricted shares.

Performance-Related Restricted Shares

We grant to certain employees restricted shares, in which the amount of shares is dependent upon performance conditions. The number of shares which will be issued ranges from zero to 150% of the target award. Compensation expense is recognized using the graded method and is based upon the fair market value of the shares estimated to be attained. The fair value of the restricted shares is estimated on the date of grant using the same valuation model as that used for stock options and other restricted shares. We currently believe that the performance goals will be achieved and compensation cost will be recognized. If such goals are not attained, any recognized compensation cost will be reversed.

In certain circumstances under our stock-based compensation plans, we allow for the vesting of employee awards to accelerate upon retirement or to continue to vest post-employment. Prior to the adoption of SFAS No. 123R, we recognized the related compensation expense over the explicit service period. We will continue this practice for awards granted prior to July 1, 2005. For awards granted subsequent to the adoption date of SFAS No. 123R, the fair value of the award will be expensed over the employee s minimum service period rather than over the explicit vesting period. This could result in significant increases in compensation cost during periods in which stock awards are granted. Had we applied the accelerated expense recognition provisions of SFAS No. 123R to our awards (with acceleration clauses upon retirement) granted prior to July 1, 2005, compensation cost would have increased by approximately $1.0 million during the second quarter 2005. The impact would have been immaterial for the compensation expense recognized during 2004.

Employee Stock Purchase Plan (ESPP)

ARRIS offers an ESPP to certain employees. The plan is in accordance with Section 423 of the U.S. Internal Revenue Code, which provides that employees will not be immediately taxed on the difference between the market price of the stock and a discounted purchase price if it meets certain requirements. Participants can request that up to 10% of their base compensation be applied toward the purchase of ARRIS common stock under ARRIS ESPP. Purchases by any one participant are limited to $25,000 (based upon the fair market value) in any one year. The exercise price is the lower of 85% of the fair market value of the ARRIS common stock on either the first day of the purchase period or the last day of the purchase period. A plan provision which allows for the more favorable of two exercise prices is commonly referred to as a look-back feature. Under APB Opinion No. 25, *Accounting for Stock Issued to Employees,* the ESPP was deemed noncompensatory, and therefore, no compensation expense was recognized. However, SFAS No. 123R narrows the noncompensatory exception significantly; any discount offered in excess of five percent generally will be considered compensatory and appropriately recognized as compensation expense. Additionally, any ESPP offering a look-back feature is considered compensatory. We use the Black-Scholes option valuation model to value to shares issued under the ESPP. The valuation is comprised of two components; the 15% discount of a share of common stock and 85% of a six month option held (related to the look-back feature).

Unrecognized Compensation Cost

As of September 30, 2005, there was approximately $14.4 million of total unrecognized compensation cost related to unvested share-based awards granted under our incentive plans. This compensation cost is expected to be recognized over a weighted-average period of 2.3 years.

Forward-Looking Statements

Certain information and statements contained in this Management s Discussion and Analysis of Financial Condition and Results of Operations and other sections of this report, including statements using terms such as may, expect, anticipate, intend, estimate, believe, plan, continue, could be, or similar variations or the negative thereof, forward-looking statements with respect to the financial condition, results of operations, and business of ARRIS, including statements that are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and management s beliefs and assumptions regarding these markets. These and any other statements in this document that are not statements about historical facts are forward-looking statements. We caution investors that forward-looking statements made by us are not guarantees of future performance and that a variety of factors could cause our actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Important factors that could cause results or events to differ from current expectations are

described in the risk factors below. 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.

Risk Factors

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

Our performance has been largely dependent on customers capital spending for constructing, rebuilding, maintaining or upgrading broadband communications systems. Capital spending in the telecommunications industry is cyclical. A variety of factors will affect the amount of capital spending, and therefore, our sales and profits, including:

general economic conditions;

availability and cost of capital;

other demands and opportunities for capital;

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regulations;

demands for network services;

competition and technology;

real or perceived trends or uncertainties in these factors; and

acceptance of new services offered by our customers.

Developments in the industry and in the capital markets over the past several years have reduced access to funding for new and existing customers, causing delays in the timing and scale of deployments of our equipment, as well as the postponement or cancellation of certain projects by our customers. In addition, during the same period, we and other vendors received notification from several customers that they were canceling new projects or scaling back existing projects or delaying new orders to allow them to reduce inventory levels which were in excess of their current deployment requirements.

Further, several of our customers have accumulated significant levels of debt and have recently announced, or are expected to announce, financial restructurings, including bankruptcy filings. For example, Adelphia has been operating in bankruptcy since the first half of 2002 and Cabovisao s Canadian parent, Csii, has been operating under bankruptcy protection since the middle of 2003. Even if the financial health of those companies and other customers improves, we cannot assure you that these customers will be in a position to purchase new equipment at levels we have seen in the past. In addition, the bankruptcy filing of Adelphia in June 2002 has further heightened concerns in the financial markets about the domestic cable industry. The concern, coupled with the current uncertainty and volatile capital markets, has affected the market values of domestic cable operators and may further restrict their access to capital.

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 will require us to retain skilled and experienced personnel as well as 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 larger than ARRIS. Our major competitors include:

Big Band Networks;

Cisco Systems, Inc.;

Motorola, Inc.;

Scientific-Atlanta, Inc.; and

TVC Communications, Inc.

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

Further, many of our larger competitors are in a better position to withstand any significant reduction in capital spending by customers in these markets. They often have broader product lines and market focus and therefore will

not be 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 long-standing and established relationships with domestic and foreign broadband service users. We may not be able to compete successfully in the future, and competition may harm our business.

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Our business has primarily come from several key customers. The loss of one of these customers or a significant reduction in services to one of these customers would have a material adverse effect on our business.

Our four largest customers are Cox Communications, Liberty Global, Comcast, and Time Warner. For the nine months ended September 30, 2005, sales to Cox Communications accounted for approximately 17.6% of our total revenues, sales to Liberty Global accounted for approximately 15.5%, sales to Comcast accounted for 18.4%, and sales to Time Warner accounted for 10.0%. The loss of Cox Communications, Liberty Global, Comcast, Time Warner, 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.

The broadband products that we develop and sell are subject to technological change and a trend towards open standards, which may impact our future sales and margins.

The broadband products we sell are subject to continuous technological evolution. Further, the cable industry has and will continue to demand a move towards open standards. The move towards open standards is expected to increase the number of MSOs who will offer new services, in particular, telephony. This trend is also expected to increase the number of competitors and drive capital costs per subscriber deployed down. These factors may adversely impact both our future revenues and margins.

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

On October 3, 2002, our Board of Directors approved the adoption of 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 shareholders interests. This plan could make it more difficult for a third party to acquire us or may delay that process.

We may dispose of existing product lines or acquire new product lines in transactions that may adversely impact us and our future results.

On an ongoing basis, we evaluate our various product offerings in order to determine whether any should be sold or closed and whether there are businesses that we should pursue acquiring. Future acquisitions and divestitures entail various risks, including:

the risk that acquisitions will not be integrated or otherwise perform as expected;

the risk that we will not be able to find a buyer for a product line while product line sales and employee morale will have been damaged because of general awareness that the product line is for sale; and

the risk that the purchase price obtained will not be equal to the book value of the assets for the product line that we sell.

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 are currently 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 exploit these technology applications. 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 our products:

are not cost-effective;

are not brought to market in a timely manner;

fail to achieve market acceptance; or

fail to meet industry certification standards.

Furthermore, our competitors may develop similar or alternative new technology applications 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

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of time. The loss of a strategic partner could have a material adverse effect on the progress of new products under development with that partner.

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, and this trend is expected to continue. For instance, in November 2005, Cox Communications announced a definitive agreement to sell some of its cable television systems to Cebridge Connections and, in April 2005, Adelphia announced that its assets were going to be acquired by Comcast and Time Warner. 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, and this trend may continue. The 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.

Acquisitions can involve significant risks.

We routinely consider acquisitions of, or investments in, other businesses. There are a number of risks attendant to any acquisition, including the possibility that we will overvalue the assets to be purchased, that we will not be able to successfully integrate the acquired business or assets, and that we will not be able to produce the expected level of profitability from the acquired business or assets. In addition, we might incur substantial indebtedness in order to finance an acquisition, which could require substantial payments in the future, and we might issue common stock or other securities to pay for an acquisition, in which even the acquisition may ultimately prove to be dilutive to our current stockholders. As a result, the impact of any acquisition on our future performance may not be as favorable as expected and actually may be adverse.

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 executives, marketing, engineering, technical support and sales 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 generally 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.

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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. The entire line of our products is marketed and made available to existing and 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 our manufacturers and assemblers have plants.

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

We face risks relating to currency fluctuations and currency exchange.

We 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 are exposed to various market risk factors such as fluctuating interest rates and changes in foreign currency rates. 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 contracts. There can be no assurance that our risk management strategies will be effective.

Our profitability has been, and may continue to be, volatile, which could adversely affect the price of our stock.

We have experienced several years with significant operating losses. Although we have been profitable in the past, we may not be profitable or meet the level of expectations of the investment community in the future, which could have a material adverse impact on our stock price. In addition, our operating results may be adversely affected by the timing of sales or a shift in our product mix.

We may face higher costs associated with protecting our intellectual property.

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 and may continue to receive from third parties, including some of our competitors, notices claiming that we have infringed upon third-party patents or other proprietary rights. Any of these claims, whether with or without merit, could result in costly litigation, divert the time, attention and resources of our management, delay our product shipments, or 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 adversely affected.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

In the past, we have used interest rate swap agreements, with large creditworthy financial institutions, to manage our exposure to interest rate changes. These swaps would involve the exchange of fixed and variable interest rate

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payments without exchanging the notional principal amount. During the quarter ended September 30, 2005, we did not have any outstanding interest rate swap agreements.

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

We have certain international customers who are billed in their local currency. Changes in the monetary exchange rates may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The euro and the yen are the predominant currencies of those customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the euro and the yen versus the dollar, a hypothetical 10% weakening of the U.S. dollar (as of September 30, 2005) would provide a gain on foreign currency of approximately $0.5 million. Conversely, a hypothetical 10% strengthening of the U.S. dollar would provide a loss on foreign currency of approximately $0.5 million. As of September 30, 2005, we had no material contracts, other than accounts receivable, denominated in foreign currencies.

ARRIS uses derivative financial instruments to reduce our exposure to adverse fluctuations in foreign exchange rates, specifically the Euro to the US dollar. When entered into, we formally designate and document the financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for undertaking the hedge transactions. In the third quarter 2005, we entered into a series of foreign exchange derivative contracts which we designated as cash flow hedges to hedge forecasted euro denominated sales. These contracts total 39.2 million euros and expire in various increments monthly beginning November 2005 and ending September 2006. As these contracts qualify for hedge accounting, we are applying the provisions of SFAS No.133, *Accounting for Derivative Instruments and Hedging Activities,* to account for them. As a result, we have recorded an unrealized loss (gain) of $(1.0) million in other comprehensive income as of September 30, 2005. Additionally, we enter into forward exchange contracts that are not designated as hedging instruments under SFAS No 133. Changes in the fair value of these instruments are immediately recognized in earnings in the line item other income (loss). As of September 30, 2005, these contracts totaled 7.5 million euros and expire in December 2005 During the three and nine months ended September 30, 2005, we recognized a net loss (gain) of approximately $0.2 million and $(1.9) million, respectively.

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Item 4. CONTROLS AND PROCEDURES

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

(b) *Changes in Internal Control over Financial Reporting*. Our principal executive officer and principal financial officer evaluated the changes in our internal control over financial reporting that occurred during the most recent fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there had been no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, the Company, in the fourth quarter of 2005, is in the process of upgrading its PeopleSoft Enterprise Resource Planning system from version 7.53 to 8.8. As part of this upgrade, the Company has implemented temporary internal controls designed to ensure the new version functions properly and may implement additional internal controls in the future. These changes, taken as a whole, may or may not be material.

PART II. OTHER INFORMATION

Item 6. EXHIBITS

Exhibit No.	*Description of Exhibit*
31.1	Section 302 Certification of Chief Executive Officer, filed herewith
31.2	Section 302 Certification of Chief Financial Officer, filed herewith
32.1	Section 906 Certification of Chief Executive Officer, filed herewith
32.2	Section 906 Certification of Chief Financial Officer, filed herewith

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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 and Chief Information Officer

Dated: November 9, 2005