ARRIS GROUP INC
Form 10-Q
November 14, 2003

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

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2003

of

ARRIS GROUP, INC.

A Delaware Corporation
IRS Employer Identification No. 58-2588724
SEC File Number 001-16631

11450 TECHNOLOGY CIRCLE
DULUTH, GA 30097
(678) 473-2000

ARRIS Group, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

ARRIS Group, Inc. is an accelerated filer (as defined in Rule 21b-2 of the Exchange Act).

As of October 31, 2003, 75,194,277 shares of the registrant's Common Stock, $0.01 par value, were outstanding.

ARRIS GROUP, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2003

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ARRIS GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	SEPTEMBER 30, 2003 (UNAUDITED)	D
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59,981	$
Accounts receivable (net of allowances for doubtful accounts of $18,083 in 2003 and $10,698 in 2002)	61,345	
Accounts receivable from Nortel Networks	282	
Other receivables	1,410	
Inventories	95,009	
Investments held for resale	-	
Other current assets	13,520	
Total current assets	231,547	
Property, plant and equipment (net of accumulated depreciation of $48,135 in 2003 and $44,810 in 2002)	27,177	
Goodwill	150,569	
Intangibles (net of accumulated amortization of $67,790 in 2003 and $41,506 in 2002)	41,144	
Investments	2,361	
Other assets	8,894	
	$ 461,692	$

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 25,752	$
Accrued compensation, benefits and related taxes	16,947	
Accounts payable and accrued expenses - Nortel Networks	140	
Current portion of long-term debt	1,060	
Current portion of capital lease obligations	22	
Other accrued liabilities	36,335	
Total current liabilities	80,256	
Capital lease obligations, net of current portion	-	
Long-term debt	125,365	
Total liabilities	205,621	
Membership interest - Nortel Networks	-	
Total liabilities & membership interest	205,621	
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; 75.2 million and 82.5 million shares issued and outstanding in 2003 and 2002, respectively	774	
Capital in excess of par value	586,107	
Accumulated deficit	(320,245)	
Unrealized holding gain on marketable securities	132	
Unearned compensation	(9,362)	
Unfunded pension losses	(1,219)	
Cumulative translation adjustments	(116)	
Total stockholders' equity	256,071	
	$ 461,692	$

See accompanying notes to the consolidated financial statements.

ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	THREE MONTHS ENDED SEPTEMBER 30, 2003	2002	NINE MON 2003
Net sales (includes sales to Nortel of $0 and $1,045 for the three months and $216 and $2,882 for the nine months ended September 30, 2003 and 2002, respectively)	$ 113,111	$ 180,577	$ 306,
Cost of sales	81,269	115,360	222,
Gross profit	31,842	65,217	83,
Operating expenses:			
Selling, general and administrative and development	35,058	46,106	115,
Restructuring and impairment charges	-	-	

Amortization of intangibles	8,812	8,708	26,
	43,870	54,814	142,
Operating income (loss)	(12,028)	10,403	(58,
Interest expense	2,881	2,123	7,
Membership interest	-	2,659	2,
Loss (gain) on debt retirement	-	-	(28,
Loss (gain) on investments	(19)	901	
Loss (gain) in foreign currency	(234)	(307)	(2,
Other expense (income), net	(63)	134	(
Income (loss) from continuing operations before income taxes	(14,593)	4,893	(38,
Income tax expense (benefit)	-	-	
Net income (loss) from continuing operations	(14,593)	4,893	(38,
Income (loss) from discontinued operations	-	(1,406)	
Net income (loss) before cumulative effect of an accounting change	(14,593)	3,487	(38,
Cumulative effect of accounting change	-	-	
Net income (loss)	$ (14,593)	$ 3,487	$ (38,
Net income (loss) per common share - Basic and diluted:			
Income (loss) from continuing operations	$ (0.19)	$ 0.06	$ (0
Income (loss) from discontinued operations	-	(0.02)	
Cumulative effect of an accounting change	-	-	
Net income (loss)	$ (0.19)	$ 0.04	$ (0
Weighted average common shares:			
Basic	75,039	82,506	77,
Diluted	75,039	83,110	77,

See accompanying notes to the consolidated financial statements.

ARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	NINE MONTHS EN SEPTEMBER 3
	2003

Operating activities:	
Net income (loss)	$ (38,916)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Depreciation	13,217
Amortization of intangibles	26,284
Amortization of deferred financing fees	3,371
Amortization of unearned compensation	2,254
Provision for doubtful accounts	7,860
Loss on disposal of fixed assets	11
Loss on investments	995
Cash proceeds from sale of trading securities	226
Loss (gain) on debt retirement	(28,506)
Loss on sale of ESP product line	1,373
Loss (gain) on sale of discontinued product line	(2,000)
Cumulative effect of an accounting change - goodwill	-
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:	
Accounts receivable	10,278
Other receivables	1,744
Inventory	9,763
Accounts payable and accrued liabilities	(21,850)
Income taxes recoverable	-
Accrued membership interest	2,418
Other, net	(589)
Net cash provided by (used in) operating activities	(12,067)
Investing activities:	
Purchases of property, plant and equipment	(4,213)
Cash proceeds from sale of Keptel product line	-
Cash proceeds from sale of Actives product line	1,800
Cash paid for acquisitions	(2,842)
Cash paid for disposal of ESP product line	(231)
Other	26
Net cash provided by (used in) investing activities	(5,460)
Financing activities:	
Proceeds from issuance of debt	126,597
Redemption of membership interest	(88,430)
Repurchase and retirement of common stock	(28,000)
Payments on capital lease obligations	(2,122)
Payments on debt obligations	(24,325)
Deferred financing costs paid	(5,797)
Proceeds from issuance of stock	1,176
Net cash provided by (used in) financing activities	(20,901)
Net increase (decrease) in cash and cash equivalents	(38,428)
Cash and cash equivalents at beginning of period	98,409
Cash and cash equivalents at end of period	$ 59,981

	NINE MONTHS SEPTEMBER 2003
Noncash investing and financing activities:	
Net tangible assets acquired, excluding cash	$ 2,370
Net liabilities assumed	(2,135)
Intangible assets acquired, including goodwill	2,607
Noncash purchase price, including 5,185,650 shares of common stock and fair market value of stock options issued	-
Cash paid for acquisition, net of cash acquired	$ 2,842
Equity issued in exchange for 4 1/2% convertible subordinated notes due 2003	$ -
Supplemental cash flow information:	
Interest paid during the period	$ 3,568
Income taxes paid during the period	$ 45

See accompanying notes to the consolidated financial statements.

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

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

ARRIS Group, Inc., the successor to ANTEC Corporation (together with its consolidated subsidiaries, except as the context otherwise indicates, "ARRIS" or the "Company"), is a global broadband communications technology company, headquartered in Duluth, Georgia. ARRIS specializes in the design, engineering, development, and distribution of products for hybrid fiber-coax broadband networks. The Company provides its customers with products and services that enable reliable, high-speed, two-way broadband transmission of telephony, data, and video services.

ARRIS operates in one business segment, Communications, providing a range of customers with network and system products and services for hybrid fiber-coax networks for the communications industry. This segment accounts for 100% of consolidated sales, operating profit and identifiable assets of the Company. ARRIS provides a broad range of products and services to cable system operators and telecommunication providers. ARRIS is a leading developer, manufacturer/supplier of telephony, data, construction, rebuild and maintenance equipment for the broadband communications industry. ARRIS supplies most of the products required in a broadband communication system, including headend and customer premises equipment for the provision of telephony and high-speed data over broadband cable networks, and a wide variety of construction, maintenance equipment, and supplies.

In 2002, ARRIS sold the Keptel and Actives product lines, which have been accounted for as discontinued operations in accordance with Statement of

Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. As a result, these two product lines and historical results have been reclassified for all periods presented. See further discussion in Note 5 of Notes to the Consolidated Financial Statements.

The consolidated financial statements furnished herein 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 2003 financial statement presentation. Interim results of operations are not necessarily indicative of results to be expected from a twelve-month period. These interim 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 Company's year ended December 31, 2002, as filed with the United States Securities and Exchange Commission.

NOTE 2. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability if, at inception, the monetary value of the obligation is based solely or predominantly on a fixed monetary amount known at inception, variations in something other than the fair value of the issuer's equity shares or variations inversely related to changes in the fair value of the issuer's equity shares. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted this standard and it did not have a material impact on the Company's financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends and clarifies accounting for derivative instruments including certain derivative instruments embedded in other contracts and hedging activities under SFAS No. 133. It is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company has adopted SFAS No. 149 and it did not have a material impact on the Company's financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51. This Interpretation provides clarification on the consolidation of certain entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Such entities are defined as variable interest entities ("VIEs"). This Interpretation requires that VIEs be consolidated by the entity considered to be the primary beneficiary of the VIE. The Interpretation is effective immediately for newly created VIEs after January 31, 2003 and was originally effective July 1, 2003 for any VIEs created prior to February 1, 2003. In October 2003, the FASB agreed to a deferral of the effective date of the Interpretation for public companies until periods ending after December 15, 2003. The Company is still evaluating the impact of Interpretation No. 46.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. The Company adopted SFAS No. 148 on January 1, 2003. See Note 3 of Notes to the Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57, and 107 and a rescission of FASB Interpretation No. 34 ("FIN 45"). The Company adopted FIN 45 as of January 1, 2003. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of FIN 45 are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 31, 2002, and are discussed in Note 4 of Notes to the Consolidated Financial Statements. The Company may, from time to time under certain circumstances, grant trade-in rights with respect to certain products. The trade-in rights are recorded in accordance with FIN 45, which may have a material impact on the Company's results of operations. When trade-in rights are granted at the time of sale, a portion of the sale is treated as a guarantee and is deferred until the trade-in right is exercised or the right expires. In determining the deferral amount, management estimates the expected trade-in rate and future value of the product upon trade-in. These factors are periodically reviewed and updated by management, and the updates may result in either an increase or decrease in the deferral. The adoption of FIN 45 did not have a material impact on the Company's results of operations or financial condition as of September 30, 2003.

In November 2002, the Emerging Issues Task Force ("EITF") of the FASB reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services or rights to use assets. The Company has adopted EITF 00-21, and the provisions of EITF 00-21 apply to revenue arrangements entered into after June 15, 2003. This accounting pronouncement did not have a significant impact on the Company's financial position or results of operations as of September 30, 2003.

NOTE 3. STOCK-BASED COMPENSATION

The Company uses the intrinsic value method for valuing its awards of stock options and restricted stock and records the related compensation expense, if any, in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. No stock-based employee or director compensation cost for stock options is reflected in net income, as all options granted have 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. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to all stock-based employee compensation.

	THREE MONTHS ENDED SEPTEMBER 30,		NI
	2003	2002	
	----	----	

Net income (loss), as reported	$ (14,593)	$ 3,487	$
Add: Stock-based employee compensation included in reported net income, net of taxes	1,001	418	
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of taxes	(4,393)	(7,444)	
Net income (loss), pro forma	$ (17,985)	$ (3,539)	$
Net income (loss) per common share:			
Basic - as reported	$ (0.19)	$ 0.04	$
Basic - pro forma	$ (0.24)	$ (0.04)	$
Diluted - as reported	$ (0.19)	$ 0.04	$
Diluted - pro forma	$ (0.24)	$ (0.04)	$

NOTE 4. GUARANTEES

Warranty

ARRIS provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers, the estimated warranty obligation could be affected by changes in ongoing product failure rates, material usage and service delivery costs incurred in correcting a product failure as well as specific product class 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, to the estimated warranty liability would be recorded. ARRIS evaluates its warranty obligations on a product line basis.

Information regarding the changes in ARRIS' aggregate product warranty liabilities was as follows for the nine-month period ended September 30, 2003 (in thousands):

Balance at December 31, 2002....................................	$ 6,031
Accruals related to warranties (including changes in estimates)...	1,024
Settlements made (in cash or in kind)............................	(1,925)
Balance at September 30, 2003..................................	$ 5,130

NOTE 5. DISCONTINUED OPERATIONS

Upon evaluation and review of the ARRIS product portfolio, the Company concluded that the Keptel product line was not core to its long-term strategy and thus sold the product line on April 24, 2002. Keptel designed and marketed network interface systems and fiber optic cable management products primarily for traditional residential and commercial telecommunications applications. The transaction generated cash proceeds of $30.0 million. Additionally, ARRIS retained a potential earn-out over a twenty-four month period based on the achievement of sales targets. The transaction also included a distribution agreement whereby the Company will continue to distribute Keptel products until April 2005. Total assets of approximately $31.1 million were disposed of, which included inventory, fixed assets, intangibles (formerly classified as goodwill), and other assets. ARRIS incurred approximately $5.0 million of related closure costs, including severance, vendor liabilities, outside consulting fees, and other shutdown expenses. During 2002, a net loss of $6.1 million was recorded in connection with the sale of the Keptel product line. As of September 30, 2003, approximately $0.9 million related to outside consulting fees remained in an accrual to be paid. ARRIS expects to complete the remaining payments by the end of 2003.

Upon continued review of ARRIS' product portfolio, the Company sold its Actives product line on November 21, 2002, for net proceeds of $31.8 million. Total assets of approximately $20.3 million were disposed of, which included inventory, fixed assets, and other assets attributable to the product line. Additionally, ARRIS incurred approximately $7.3 million of related closure costs, including severance, vendor liabilities, professional fees, and other shutdown expenses. In connection with the sale, the Company recognized a gain of approximately $2.2 million

in 2002. During the second quarter of 2003, the Company reduced its accrual for vendor liabilities by $2.0 million as a result of settling certain vendor liabilities for amounts less than originally anticipated. With this adjustment, the Company has now recognized a cumulative gain of approximately $4.2 million related to the transaction. As of September 30, 2003, approximately $0.1 million related to severance, $2.8 million related to vendor liabilities, and $0.9 million related to other shutdown expenses remained in an accrual to be paid. ARRIS expects to complete the remaining payments by the end of 2003.

The Company's Keptel and Actives product lines, as a whole, constituted the majority of its transmission, optical and outside plant product category and qualified as discontinued operations in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the results of these product lines have been reclassified to discontinued operations for all periods presented. The remaining product lines within the transmission, optical and outside plant product category have been reclassified to the supplies and services product category.

Revenues from discontinued operations were $17.0 million and $53.8 million for the three and nine months ended September 30, 2002, respectively. The net loss from discontinued operations, net of taxes, for the three and nine months ending September 30, 2002 was $(1.4) million and $(20.5) million, respectively. During 2002, the Company recorded a net loss on these disposals of $(4.0) million. During 2003, the Company recorded a gain of $2.0 million related to the Actives adjustment described above, resulting in a cumulative net loss of $(2.0) million related to the disposal of discontinued operations. This $2.0 million gain on disposal of discontinued operations was offset by an approximately $2.0 million increase in the accrual for restructuring liabilities associated with the discontinued operations of the Company's manufacturing facilities. See Note 6 of Notes to the Consolidated Financial Statements.

NOTE 6. BUSINESS ACQUISITIONS

ACQUISITION OF CERTAIN ASSETS OF COM21

On August 13, 2003, the Company completed the acquisition of certain cable modem termination system (CMTS) related assets of Com21, including the stock of its Irish subsidiary. Under the terms of the agreement, ARRIS obtained accounts receivable, inventory, fixed assets, other current prepaid assets, and existing technology in exchange for approximately $2.4 million of cash, of which $2.2 million has been paid, and the assumption of approximately $0.6 million in liabilities. The Company has retained $0.2 million of the cash consideration for any liabilities which ARRIS may be required to pay resulting from Com21 activity prior to the acquisition date. The Company also incurred approximately $0.2 million of legal and professional fees associated with the transaction. ARRIS retained approximately 50 Com21 employees. The Company completed this acquisition because it believes that the newly acquired product line, along with the existing product offerings of ARRIS, will allow the Company to reach smaller scale cable systems domestically and internationally.

The following is a summary of the preliminary purchase price allocation to record ARRIS' purchase of certain assets of Com21, including the stock of the Irish subsidiary of Com21. The purchase price was equal to the net tangible and intangible assets acquired. The final allocation of the purchase price will be determined after completion of thorough analyses to identify and determine the fair values of Com21's tangible and identifiable intangible assets and liabilities as of the date the transaction was completed.

	(IN THOUSANDS)
Cash paid to Com21	$ 2,213
Cash retainer..	200
Acquisition costs	210
Assumption of certain liabilities of Com21	634
Adjusted preliminary purchase price	$ 3,257
Allocation of preliminary purchase price:	
Net tangible assets acquired	$ 1,357
Existing technology (to be amortized over 3 years)...	1,900
Total allocated preliminary purchase price	$ 3,257

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ACQUISITION OF ATOGA SYSTEMS

On March 21, 2003, ARRIS purchased the business and certain assets of Atoga Systems, a Fremont, California-based developer of optical transport systems for metropolitan area networks. The Company decided to undertake this transaction because it would expand the Company's existing broadband product portfolio and is anticipated to have a positive impact on future results of the Company. Under the terms of the agreement, ARRIS obtained certain inventory, fixed assets, and existing technology in exchange for approximately $0.4 million of cash and the assumption of certain lease obligations. Further, the Company retained 28 employees and issued a total of 500,000 shares of restricted stock to those employees. The value of the restricted stock will be recognized as compensation expense over the related vesting period.

The following is a summary of the preliminary purchase price allocation to record ARRIS' purchase price of the assets and certain liabilities of Atoga Systems. The final allocation of the purchase price will be determined after completion of thorough analyses to identify and determine the fair values of Atoga Systems' tangible and identifiable intangible assets and liabilities as of the date the transaction was completed.

	(IN THOUSANDS)
Cash paid to Atoga Systems	$ 434
Acquisition costs (legal fees)	100
Assumption of certain liabilities of Atoga Systems	1,162
Adjusted preliminary purchase price	$ 1,696
Allocation of preliminary purchase price:	
Net tangible assets acquired	$ 1,013
Existing technology (to be amortized over 3 years)...	683
Total allocated preliminary purchase price	$ 1,696

ACQUISITION OF CADANT, INC.

On January 8, 2002, ARRIS completed the acquisition of all of the assets and business of Cadant, Inc., a privately held designer and manufacturer of next generation Cable Modem Termination Systems ("CMTS"). The Company acquired Cadant because it provided significant broadband product and technology extensions of its existing product portfolio. As a part of this transaction:

- ARRIS issued 5,250,000 shares of ARRIS common stock for the purchase of substantially all of Cadant's assets and certain liabilities.

- During the second quarter of 2003, 64,350 shares of ARRIS common stock were returned to ARRIS and retired. This transaction was pursuant to the terms of a settlement agreement between ARRIS and the trustee in the liquidation of CDX Corporation (formerly know as Cadant).

- ARRIS agreed to pay up to 2.0 million shares based upon future sales of the CMTS product through January 8, 2003. These targets were not met as of January 8, 2003, and therefore, no further shares were issued.

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The following is a summary of the purchase price allocation to record ARRIS' purchase price of the assets and certain liabilities of Cadant, Inc. for 5,250,000 shares of ARRIS Group, Inc. common stock based on the average closing price of ARRIS' common stock for 5 days prior and 5 days after the date of the transaction as quoted on the Nasdaq National Market System. The excess of the purchase price over the fair value of the net tangible and intangible assets acquired has been allocated to goodwill.

	(IN THOUSANDS)
5,250,000 shares of ARRIS Group, Inc.'s $0.01 par value common stock at $10.631 per common share	$ 55,813
64,350 returned shares of ARRIS Group, Inc.'s $0.01 par value common stock at $10.631 per common share	(684)
Acquisition costs (banking fees, legal and accounting fees, printing costs)	897

Fair value of stock options to Cadant, Inc. employees	12,760
Assumption of certain liabilities of Cadant, Inc.	14,858
Adjusted purchase price	$ 83,644
Allocation of Purchase Price:	
Net tangible assets acquired	$ 5,001
Existing technology (to be amortized over 3 years)	53,000
Goodwill (not deductible for income tax purposes)	25,643
Total allocated purchase price	$ 83,644

SUPPLEMENTAL PRO FORMA INFORMATION

Presented below is summary unaudited pro forma combined financial information for the Company, Com21, Atoga Systems, and Cadant, Inc. to give effect to the transactions. This summary unaudited pro forma combined financial information is derived from the historical financial statements of the Company, Com21, Atoga Systems, and Cadant, Inc. This information assumes the transaction was consummated at the beginning of the applicable period. This information is presented for illustrative purposes only and does not purport to represent what the financial position or results of operations of the Company, Com21, Atoga Systems, and Cadant, Inc., or the combined entity would actually have been had the transactions occurred at the applicable dates, or to project the Company's, Com21's, Atoga Systems', and Cadant, Inc.'s, or the combined entity's results of operations for any future period or date. The actual results of Com21 are included in the Company's operations from August 13, 2003 to September 30, 2003. The actual results of Atoga Systems are included in the Company's operations from March 21, 2003 to September 30, 2003. The actual results of Cadant, Inc. are included in the Company's operations from January 8, 2002 to September 30, 2003.

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTH
	2003	2002	2003
	(IN THOUSANDS, EXCEPT PER SHARE (UNAUDITED)		
Net sales	$ 113,111	$ 180,782	$ 306,16
Gross profit	31,842	65,143	83,77
Operating income (loss)	(12,606)	5,310	(64,42
Income (loss) before income taxes	(15,220)	(297)	(44,72
Income (loss) from continuing operations	(15,220)	(297)	(44,72
Income (loss) from discontinued operations ..	-	(1,406)	
Net income (loss) before cumulative effect of an accounting change	(15,220)	(1,703)	(44,72
Net income (loss)	$ (15,220)	$ (1,703)	$ (44,72
Net income (loss) per common share:			
Diluted	$ (0.20)	$ (0.02)	$ (0.5
Weighted average common shares:			
Diluted	75,039	83,110	77,33

The following table represents the amount assigned to each major asset and liability caption of Com21 as of August 13, 2003, Atoga Systems as of March 21, 2003 and Cadant, Inc. as of January 8, 2002, as adjusted:

	AS OF ACQUISITION DATE (IN THOUSANDS)		
	COM21	ATOGA SYSTEMS	CADANT, INC.
Total current assets......................	$ 273	$ 330	$ 782
Property, plant and equipment, net.........	$ 1,084	$ 683	$ 4,219
Goodwill..................................	$ -	$ -	$ 25,643
Intangible assets	$ 1,900	$ 683	$ 53,000
Total assets..............................	$ 3,257	$ 1,696	$ 83,644
Total current and long-term liabilities ...	$ 634	$ 1,162	$ 14,858

NOTE 7. BUSINESS DIVESTITURE - ELECTRONIC SYSTEM PRODUCTS ("ESP")

On August 18, 2003, ARRIS sold its engineering consulting services product line, known as ESP, to an unrelated third party. The agreement involved the transfer of net assets of approximately $1.3 million, which included accounts receivable, fixed assets, an investment, and other assets attributable to the product line. Further, the transaction provided for the transfer of approximately 30 employees. Additionally, the Company incurred approximately $0.1 million of related closure costs, primarily legal and professional fees associated with the closing. ARRIS recognized a loss on the sale of approximately $1.4 million during the third quarter 2003. The ESP product line contributed revenue of approximately $0.2 million and $1.3 million during the three and nine-month periods ended September 30, 2003, respectively, and revenue of $0.7 million and $2.5 million during the three and nine-month periods ended September 30, 2002, respectively. The ESP revenue is classified in the supplies product category. In accordance with the provisions of SFAS No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets, ESP is not reflected as a discontinued operation because it was determined to be an insignificant component of the Company's consolidated operations and assets. As of September 30, 2003, approximately $0.1 million related to legal and professional fees remained in an accrual to be paid. ARRIS expects to complete the remaining payments by the end of 2003.

NOTE 8. RESTRUCTURING AND OTHER CHARGES

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 the consolidation of its facilities. The closure affected approximately 75 employees and will be substantially completed by the end of 2003. In connection with these actions, the Company recorded a charge of approximately $7.1 million in the fourth quarter of 2002. Included in this restructuring charge was approximately $2.1 million related to remaining lease payments, $2.7 million of fixed asset write-offs, $2.1 million of severance, and $0.2 million of other costs associated with these actions. As of September 30, 2003, approximately $1.3 million related to lease commitments, $0.2 million related to severance, and $0.2 million related to other costs remained in the restructuring accrual to be paid. ARRIS expects to complete the remaining payments by the second quarter of 2006 (end of lease).

In the fourth quarter of 2001, ARRIS closed a research and development facility in Raleigh, North Carolina and recorded a $4.0 million charge related to severance and other costs associated with closing that facility. This charge included termination expenses of $2.2 million related to the involuntary dismissal of 48 employees, primarily engaged in engineering functions at that facility. Also included in the $4.0 million charge was $0.7 million related to lease commitments, $0.2 million related to the impairment of fixed assets, and $0.9 million related to other shutdown expenses. In September 2003, ARRIS took advantage of an early buyout clause in connection with the remaining lease payments, which reduced the Company's original estimate of restructuring expense by approximately $0.4 million. As of September 30, 2003, the Company has no remaining liabilities related to this closure.

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. The plan entailed the implementation of an expanded manufacturing outsourcing strategy and the related

closure of the four factories located in El Paso, Texas and Juarez, Mexico. As a result, the Company recorded restructuring and impairment charges of $66.2 million, of which approximately $50.1 million relates to and is classified in discontinued operations. Included in these charges was approximately $33.7 million related to the write-down of inventories, and remaining warranty and purchase order commitments of which approximately $8.6 million was reflected in cost of goods sold and $25.1 million was reflected in discontinued operations. Additional charges incurred were approximately $5.7 million related to severance and associated personnel costs, $5.9 million related to the impairment of goodwill due to the sale of the power product lines, $14.8 million related to the impairment of fixed assets, and approximately $6.1 million related to lease terminations of factories and office space and other shutdown expenses. Of these charges, approximately $7.5 million is reflected in restructuring expense and $25.0 million is reflected in discontinued operations. The personnel-related costs included termination expenses for the involuntary dismissal of 807 employees, primarily engaged in production and assembly functions performed at the facilities. ARRIS offered terminated employees separation amounts in accordance with the Company's severance policy and provided the employees with specific separation dates. Due to unforeseen delays in exiting the facility after the shutdown, the Company increased its reserve by approximately $2.4 million and $2.0 million during the fourth quarter 2002 and the second quarter 2003, respectively, charged to discontinued operations. As of September 30, 2003, approximately $0.1 million related to severance and associated personnel costs, and $2.1 million related to lease terminations of factories and office space and other shutdown costs remained in an accrual to be paid. ARRIS expects to complete the remaining payments by the end of the first quarter 2004.

NOTE 9. INVENTORIES

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

	SEPTEMBER 30, 2003	DECEMBER 31, 2002

	(UNAUDITED)	
Raw material................................	$ 4,996	$ 3,941
Finished goods..............................	90,013	100,262
Total inventories.....................	$ 95,009	$ 104,203

NOTE 10. PROPERTY, PLANT AND EQUIPMENT

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

	SEPTEMBER 30, 2003	DECEMBER 31, 2002
	(UNAUDITED)	
Land	$ 1,822	$ 1,822
Building and leasehold improvements	7,702	7,295
Machinery and equipment	65,788	70,233
	75,312	79,350
Less: Accumulated depreciation	(48,135)	(44,810)
Total property, plant and equipment, net...	$ 27,177	$ 34,540

NOTE 11. GOODWILL AND INTANGIBLE ASSETS

ARRIS adopted SFAS No. 142, Goodwill and Other Intangible Assets, on January 1, 2002. Upon adoption of SFAS No. 142, the Company recorded a goodwill impairment loss of approximately $58.0 million, primarily related to the Keptel product line, based upon management's analysis including an independent valuation. The resulting impairment loss has been recorded as a cumulative effect of a change in accounting principle on the accompanying Consolidated Statements of Operations for the nine months ended September 30, 2002. The valuation was determined using a combination of the income and market approaches on an invested capital basis, which is the market value of equity plus interest-bearing debt. The Company's remaining goodwill was reviewed in the fourth quarter of 2002, and based upon management's analysis including an independent valuation, an impairment charge

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of $70.2 million was recorded with respect to its supplies product category. The Company will analyze its goodwill on an annual basis during the fourth quarter of each year or on an interim basis if circumstances change that would indicate the possibility of an impairment.

The changes in the carrying amount of goodwill for the year ended December 31, 2002 and for the nine months ended September 30, 2003 are as follows (in thousands):

Balance as of December 31, 2001...	$ 259,062
Transitional impairment charge..	(57,960)

Purchase price allocation adjustment - Arris Interactive L.L.C............	33
Goodwill in connection with Cadant, Inc. acquisition......................	26,339
Transferred to intangible asset upon adoption of SFAS No. 142.............	(6,000)
Goodwill impairment charge, October 1, 2002...............................	(70,209)
Balance as of December 31, 2002...	$ 151,265
Purchase price allocation adjustments - Cadant, Inc. (see Note 6)..........	(696)
Balance as of September 30, 2003..	$ 150,569

The gross carrying amount and accumulated amortization of the Company's intangible assets, other than goodwill, as of September 30, 2003 and December 31, 2002 are as follows (in thousands):

	SEPTEMBER 30, 2003 (UNAUDITED)			DEC
	GROSS AMOUNT	ACCUMULATED AMORTIZATION	NET BOOK VALUE	GROSS AMOUNT
Existing technology acquired:				
Arris Interactive L.L.C	$ 51,500	$ (37,053)	$ 14,447	$ 51,500
Cadant, Inc.	53,000	(30,578)	22,422	53,000
Atoga Systems	685	(113)	572	-
Com21	1,900	(46)	1,854	-
Pension asset	1,849	-	1,849	1,849
Total	$ 108,934	$ (67,790)	$ 41,144	$ 106,349

Amortization expense recorded on the intangible assets listed in the above table for the three months ended September 30, 2003 and 2002 was $8.8 million and $8.7 million, respectively. Amortization expense for the nine months ended September 30, 2003 and 2002 was $26.3 million and $25.8 million, respectively. The estimated remaining amortization expense is as follows (in thousands):

2003................	$ 8,957
2004................	$ 28,683
2005................	$ 1,200
2006................	$ 455
2007................	$ -

NOTE 12. LONG TERM DEBT, CAPITAL LEASE OBLIGATIONS AND MEMBERSHIP INTEREST

Long term debt, capital lease obligations and membership interest consist of the following (in thousands):

	SEPTEMBER 30, 2003 (UNAUDITED)	DECEMBER 31, 2002

Capital lease obligations	$ 22	$ 1,278
Machinery and equipment notes payable	1,425	-
Membership interest -Nortel Networks	-	114,518
4.5% Convertible Subordinated Notes due 2003	-	23,887
4.5% Convertible Subordinated Notes due 2008	125,000	-
Total debt, capital lease obligations and membership interest	126,447	139,683
Less current portion	(1,082)	(25,007)
Total long term debt, capital lease obligations and membership interest	$ 125,365	$ 114,676

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On March 18, 2003, the Company issued $125.0 million of 4 1/2% Convertible Subordinated Notes due 2008 ("Notes due 2008"). The Notes due 2008 are 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. The Notes due 2008 will pay interest semi-annually, based on an annual rate of 4 1/2%, on March 15 and September 15 of each year, commencing September 15, 2003. The Company used approximately $88.4 million of the proceeds from the issuance, including the reduction in the forgiveness of the Class B membership interest, to redeem the Class B membership interest in Arris Interactive held by Nortel Networks resulting in a gain of approximately $28.5 million, recorded in operations in accordance with SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. The Company used approximately $28.0 million of the proceeds of the issuance to repurchase and retire 8 million shares of its common stock held by Nortel Networks at a discount. As of September 30, 2003, there were $125.0 million of the Notes due 2008 outstanding.

In 1998, the Company issued $115.0 million of 4 1/2% Convertible Subordinated Notes due May 15, 2003 ("Notes due 2003"). The Notes due 2003 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 $24.00 per share. In 2002, ARRIS exchanged 1,593,789 shares of its common stock for approximately $15.4 million of the Notes due 2003. Additionally, the Company redeemed $23.9 million and $75.7 million of the Notes due 2003 during 2003 and 2002, respectively, using cash. As of May 15, 2003, all of the Notes due 2003 were redeemed.

The Company has in place an asset-based revolving credit facility (the "Credit Facility") permitting the Company to borrow up to $92.5 million (which can be increased under certain conditions by up to $25.0 million), based upon availability under a borrowing base calculation. In general, the borrowing base is limited to 85% of net eligible receivables (with a cap of $5.0 million in relation to foreign receivables), subject to a reserve of $10.0 million. In addition, upon obtaining appropriate asset appraisals the Company may include in the borrowing base calculation 80% of the orderly liquidation value of net eligible inventory (not to exceed $60.0 million). The Credit Facility contains traditional financial covenants, including fixed charge coverage, senior debt leverage, minimum net worth, and minimum inventory turns ratios. The facility is secured by substantially all of the Company's assets. The Credit Facility has a maturity date of August 3, 2004. The commitment fee on unused borrowings is 0.75%.

The Credit Facility was amended in January 2003 to provide that the minimum net worth covenant applied only to the period prior to December 31, 2002. In March 2003, ARRIS amended its credit facility to permit the Company to issue up to

$125.0 million of the Notes due 2008, to use the proceeds of such notes as described above. The amendment also reduced the revolving loan commitments by $10.0 million to $115.0 million. The Credit Facility was further amended in August 2003 to reduce the aggregate revolving loan commitments to $92.5 million and to waive the fixed charge coverage ratio for the third and fourth quarters of 2003. In conjunction with obtaining the waiver, the financial covenants were expanded to include EBITDA covenants for the third and fourth quarters of 2003. The EBITDA covenant for the third quarter 2003 was met and the Company anticipates meeting the covenant in the fourth quarter.

As of September 30, 2003, ARRIS had no borrowings outstanding under its credit facility and approximately $7.0 million outstanding under letters of credit. The Company had approximately $47.1 million of available borrowing capacity.

In connection with the acquisition of Arris Interactive in August 2001, Nortel Networks exchanged its remaining ownership interest in Arris Interactive for 37 million shares of ARRIS common stock and a subordinated redeemable Class B membership interest in Arris Interactive with a face amount of $100.0 million. The Class B membership interest earned an accreting non-cash return of 10% per annum, compounded annually, and was redeemable in approximately four quarterly installments commencing February 3, 2002, provided that certain availability and other tests are met under the Company's Credit Facility. Those tests were not met. In June 2002, ARRIS entered into an option agreement with Nortel Networks that permitted ARRIS to redeem the Class B membership interest in Arris Interactive at a discount of 21% prior to June 30, 2003. To further induce the Company to redeem the Class B membership interest, Nortel Networks offered to forgive approximately $5.9 million of the amount owed Nortel Networks if ARRIS redeemed it prior to March 31, 2003. The Company used

approximately $88.4 million of the proceeds, including the reduction in the forgiveness of the Class B membership interest, of Notes due 2008 to redeem the Class B membership interest at a discount resulting in a gain of approximately $28.5 million, recorded in operations in accordance with SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.

In conjunction with the acquisition of Cadant, Inc. and Atoga Systems, the Company assumed capital lease obligations and a note payable related to machinery and equipment. The leases required future rental payments until 2005; however, during the third quarter 2003, the Company paid the remaining Cadant lease payments at an early buyout discount using the proceeds of a new note payable. The new note payable is due January 2005 with an interest rate of 5% per annum. The balance of the remaining capital lease obligations and notes payable at September 30, 2003 was approximately $1.4 million.

ARRIS has not paid cash dividends on its common stock since its inception. The Company's credit agreement contains covenants that prohibit it from paying such dividends. 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) for the three-month periods ended September

30, 2003 and 2002 was $(14.6) million and $3.8 million, respectively. Total comprehensive income (loss) for the nine-month periods ended September 30, 2003 and 2002 was $(39.1) million and $(97.5) million, respectively. Such comprehensive loss, which is recorded as a separate component of stockholders' equity, differs from net loss due to cumulative translation adjustments and unrealized holding gains (losses) on marketable securities.

NOTE 14. SALES INFORMATION

A significant portion of ARRIS' revenue is derived from sales to Comcast and Cox Communications. Sales to these two customers for the three and nine-month periods ended September 30, 2003 and 2002 are set forth below (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Comcast	$ 35,809	$ 89,548	$ 95,540	$ 215,240
% of sales	31.7%	49.6%	31.2%	40.7%
Cox Communications	$ 29,801	$ 23,647	$ 74,748	$ 76,627
% of sales	26.3%	13.1%	24.4%	14.5%

ARRIS operates globally and offers products and services that are sold to cable system operators and telecommunications providers. ARRIS' products and services are focused in two product categories, Broadband and Supplies, instead of the previous three categories. As a result of the sale of the Company's Keptel and Actives product lines in 2002, revenues from the remaining product lines within the former Transmission, Optical, and Outside Plant product category are now reported with the Supplies product category. All prior period revenues have been aggregated to conform to the new product categories. Consolidated revenues by principal products category for the three and nine-month periods ended September 30, 2003 and 2002 were as follows (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
PRODUCT CATEGORY				
Broadband.............	$ 75,050	$ 132,341	$ 203,232	$ 370,643
Supplies..............	38,061	48,236	102,932	158,833
Total sales.......	$ 113,111	$ 180,577	$ 306,164	$ 529,476

The Company sells its products primarily in the United States with its international revenue being generated from Asia Pacific, Europe, Latin America and Canada. The Asia Pacific market primarily includes China, Hong Kong, Japan, Korea, and Singapore. The European market primarily includes Austria, Germany, France, Netherlands, Poland, Portugal, Romania, Spain, and Switzerland. The Latin American market primarily includes Argentina, the Bahamas, Chile, Colombia, Mexico, and Puerto Rico. Sales to international customers were approximately 17.5%, and 24.2% of total sales for the quarters ended September 30, 2003 and 2002, respectively. Sales for the three and nine-month periods ended September 30, 2003 and 2002 are as follows (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEP	
	2003	2002	2003	
INTERNATIONAL REGION				
Asia Pacific....................	$ 7,077	$ 11,585	$ 22,346	$
Europe..........................	6,119	13,454	18,972	
Latin America...................	2,066	6,735	5,596	
Canada..........................	2,272	2,248	7,108	
Total international sales.....	17,534	34,022	54,022	
Total domestic sales..........	95,577	146,555	252,142	
Total sales.................	$ 113,111	$ 180,577	$ 306,164	$

Total identifiable international assets were immaterial.

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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,		NINE MON
	2003	2002	20
Basic:			
Income (loss) from continuing operations......	$ (14,593)	$ 4,893	$ (3
Income (loss) from discontinued operations....	-	(1,406)	
Cumulative effect of an accounting change.....	-	-	
Net income (loss).........................	$ (14,593)	$ 3,487	$ (3
Weighted average shares outstanding.........	75,039	82,506	7
Basic earnings (loss) per share............	$ (0.19)	$ 0.04	$
Diluted:			
Income (loss) from continuing operations......	$ (14,593)	$ 4,893	$ (3

Income (loss) from discontinued operations	-	(1,406)	
Cumulative effect of an accounting change	-	-	
Net income (loss)	$ (14,593)	$ 3,487	$ (3
Weighted average shares outstanding	75,039	82,506	7
Net effect of dilutive stock options	-	604	
Total	75,039	83,110	7
Diluted earnings (loss) per share	$ (0.19)	$ 0.04	$

The 4 1/2% convertible subordinated notes due 2003 and 2008 were antidilutive for all periods presented. The effects of options were not presented for the three months ended September 30, 2003 and the nine months ended September 30, 2003 and 2002 as the Company incurred net losses during these periods and inclusion of these securities would be antidilutive.

NOTE 16. OPTION EXCHANGE PROGRAM

On June 27, 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. The offer expired on July 25, 2003. On July 28, 2003, ARRIS cancelled options to purchase approximately 4.7 million shares of common stock and granted approximately 1.5 million restricted shares in exchange. Employees tendered approximately 76% of the options eligible to be exchanged under the program. In accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees, the Company will record a fixed compensation expense equal to the fair market value of the shares of restricted stock granted through the offer. This cost will be amortized over the four-year vesting period for the restricted shares, and equates to a charge of approximately $0.5 million per quarter. All eligible options that were not surrendered for exchange are subject to variable accounting. This variable accounting charge will fluctuate in accordance with the market price of the ARRIS common stock until such stock options are exercised, forfeited, or expire unexercised.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses ARRIS' Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. On an on-going basis, management evaluates its estimates and judgments, including those related to customer incentives, product returns, bad debts, inventories, investments, intangible assets, income taxes, financing operations, warranty obligations, restructuring costs, retirement benefits, and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our critical accounting policies and estimates are disclosed extensively in our Form 10-K for the year ended December 31, 2002, as filed with the United States Securities and Exchange Commission. That discussion is incorporated herein by reference. In addition to the policies and estimates discussed in our most recent Form 10-K, following is a summary of our accounting policy with regards to revenue recognition.

Revenue Recognition

ARRIS' revenue recognition policies are in compliance with Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, as issued by the Securities and Exchange Commission.

Product revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is reasonably assured. Contracts and customer purchase orders generally are used to determine the existence of an arrangement. Shipping documents, proof of delivery and customer acceptance (when applicable) are used to verify delivery. Revenue is deferred if certain circumstances exist, including:

- when undelivered products or services that are essential to the functionality of the delivered product exist, revenue is deferred until such undelivered products or services are delivered,

- when final acceptance of the product is specified by the customer, revenue is deferred until the acceptance criteria have been met, or

- when trade-in rights are granted at the time of sale, a portion of the sale is treated as a guarantee and is deferred until the trade-in right is exercised or the right expires. In determining the deferral amount, management estimates the expected trade-in rate and future value of the product upon trade-in. These factors are periodically reviewed and updated by management, and the updates may result in either an increase or decrease in the deferral. Such deferrals have been immaterial to date. Actual results could materially differ from the estimates made by management. See the discussion related to FIN 45 in Note 2 of the Notes to the Consolidated Financial Statements.

ARRIS' Cadant C4 CMTS is, by design, an upgradeable product. We currently are developing a DOCSIS 2.0 module for this product, which customers can interchange for a DOCSIS 1.1 module. We anticipate that as part of some arrangements, where price, quantity and other terms support it, customers may be granted trade-in rights if the customers choose to move from DOCSIS 1.1 to DOCSIS 2.0 modules. If granted, a portion of the future sales of DOCSIS 1.1 modules will likely be deferred, in accordance with FIN 45, applying the deferral methodology described above in the description relating to trade-in rights. It is possible that other trade-in rights may also be granted in the future.

Sales of services are recognized at the time of performance. ARRIS resells software developed by outside third parties as well as internally developed software. Software sold by ARRIS does not require significant production, modification or customization. Software revenue is generally recognized when shipment is made, no significant vendor obligations remain and collection is considered reasonable assured.

OVERVIEW

Set forth below is a description of how our business performed during the three and nine-month periods ending September 30, 2003 as compared to the same periods in 2002. During the past two years, we have significantly changed our business through product portfolio actions and cost reduction actions, allowing us to focus on our long-term business strategy. As a result of our acquisitions and dispositions, our business has changed significantly and our historical results of operations are not as indicative of future results of operations as they otherwise might suggest.

CAPITAL STRUCTURE ACTIONS

Notes due 2008. On March 18, 2003, we issued $125.0 million of 4 1/2% convertible subordinated notes due March 15, 2008. These notes are convertible at the option of the holder into our common stock at $5.00 per share, subject to adjustment. We are entitled to call the notes for redemption at any time, subject to our making a "make whole" payment if we call them for redemption prior to March 15, 2006. In addition, we are required to repurchase the notes in the event of a "change in control."

We used approximately $88.4 million of the proceeds, including the reduction in the forgiveness of the Class B membership interest, of the notes issuance to redeem the entire Class B membership interest in Arris Interactive held by Nortel Networks. We used approximately $28.0 million of the proceeds of the issuance to repurchase and retire 8 million shares of our common stock held by Nortel Networks at a discount.

Credit Facility. On several occasions during 2002 we modified our credit facility in order to allow us to use existing cash reserves and proceeds of asset sales to purchase or redeem our outstanding 4 1/2% convertible subordinated notes due 2003. These modifications imposed certain conditions on the use of such cash to purchase or redeem additional notes. In March 2003, we amended the credit facility to permit us to issue up to $125.0 million of new convertible subordinated notes due 2008 and to use the proceeds of the new notes to redeem the Class B membership interest in Arris Interactive held by Nortel Networks and to purchase shares of our common stock held by Nortel Networks, subject to certain limitations. The amendment also reduced the revolving loan commitments to $115.0 million. The Credit Facility was amended in January 2003 to provide that the minimum net worth covenant applied only to the period prior to December 31, 2002. The Credit Facility was further amended in August 2003 to reduce the aggregate revolving loan commitments to $92.5 million and to waive the fixed charge coverage ratio for the third and fourth quarters of 2003. In conjunction with obtaining the waiver, the financial covenants were expanded to include EBITDA covenants for the third and fourth quarters of 2003. The EBITDA covenant for the third quarter 2003 was met and the Company anticipates meeting the covenant in the fourth quarter.

Membership Interest. In connection with the acquisition of Arris Interactive in August 2001, Nortel Networks exchanged its remaining ownership interest in Arris Interactive for 37 million shares of our common stock and a subordinated redeemable Class B membership interest in Arris Interactive with a face amount of $100.0 million. The Class B membership interest earned an accreting non-cash return of 10% per annum, compounded annually, and was redeemable in approximately four quarterly installments commencing February 3, 2002, provided that certain availability and other tests are met under our revolving credit facility. Those tests were not met. The balance of the Class B membership interest as of December 31, 2002 was approximately $114.5 million. In June 2002, we entered into an option agreement with Nortel Networks that permitted us to redeem the Class B membership interest in Arris Interactive at a discount of 21% prior to June 30, 2003. To further induce us to redeem the Class B membership interest, Nortel Networks offered to forgive an additional $5.9 million of the amount owed Nortel Networks if we redeemed it prior to March 31, 2003. We used approximately $88.4 million of the proceeds of the March 2003 convertible note offering to redeem the entire Class B membership interest.

Notes due 2003. In May 1998, we issued $115.0 million of 4 1/2% convertible subordinated notes due May 15, 2003. In 2002, we retired $91.1 million of these notes through cash repurchases and exchanges for our common stock. During the first quarter 2003, we repurchased an additional $12.4 million of the notes, and repurchased the remaining $11.5 million of the notes during the second quarter 2003 on the maturity date on May 15, 2003.

Common Stock. Of the 37 million shares of our common stock that Nortel Networks received in 2001, it sold 15 million in a registered public offering in June 2002. In order to reduce its holdings further, in March 2003 Nortel Networks granted us an option to purchase up to 16 million shares at a 10% discount to market, subject to a minimum purchase price of $3.50 per share for 8 million shares and $4.00 per share for the remainder. In addition, to the extent that we purchased shares at a price of less than $4.00 per share, we were obligated to return to Nortel Networks a portion of the return that was forgiven with respect to the Class B membership interest, up to a maximum of $2.0 million. Pursuant to this option, on March 24, 2003, we purchased 8 million shares for an aggregate purchase price of $28.0 million. Contemporaneously with this transaction, we paid Nortel Networks $2.0 million, which represented the reduction in the forgiveness of the Class B membership interest. We did not exercise the option to repurchase the remaining 8 million shares offered by Nortel Networks, which expired on June 30, 2003. On July 25, 2003, we filed a registration statement with the Securities and Exchange Commission on Form S-3 related to the registration for resale of the remaining 14 million shares of ARRIS common stock held by Nortel Networks. Pursuant to this registration statement, Nortel Networks, over the next two years, may sell up to 14 million shares of the Company's common stock in one or more offerings.

PRODUCT PORTFOLIO ACTIONS

Acquisition of Certain Assets of Com21. On August 13, 2003, we completed the acquisition of certain cable modem termination system (CMTS) related assets of Com21, including the stock of its Irish subsidiary. Under the terms of the agreement, we obtained accounts receivable, inventory, fixed assets, other current prepaid assets, and existing technology in exchange for approximately $2.4 million of cash, of which $2.2 million has been paid, and the assumption of approximately $0.6 million in liabilities. We retained $0.2 million of the cash consideration for any liabilities we may be required to pay resulting from Com21 activity prior to the acquisition date. We also incurred approximately $0.2 million of legal and professional fees associated with the transaction. We retained approximately 50 Com21 employees. We completed this acquisition because we believe that the newly acquired product line, along with the existing product offerings of ARRIS, will allow us to reach smaller scale cable systems domestically and internationally. We anticipate the transaction to be slightly dilutive to our earnings in 2003.

Acquisition of Atoga Systems. On March 21, 2003, we purchased the business and certain assets of Atoga Systems, a Fremont, California-based developer of optical transport systems for metropolitan area networks. Under the terms of the agreement, we obtained certain inventory, fixed assets, and intellectual property in consideration for approximately $0.4 million of cash and the assumption of certain obligations. Further, we retained 28 employees and issued a total of 500,000 shares of restricted stock to those employees. The value of the restricted stock will be recognized as compensation expense over the related vesting period. We anticipate the transaction to be slightly dilutive to our earnings in 2003.

Acquisition of Cadant, Inc. On January 8, 2002, we acquired substantially all of the assets of Cadant, Inc., a designer and manufacturer of next generation CMTS. Under the terms of the transaction, we issued 5.25 million shares of our common stock and assumed approximately $14.9 million in liabilities in exchange for the assets. During the second quarter of 2003, 64,350 shares of ARRIS common stock were returned to ARRIS and retired in a settlement of claims by ARRIS against the trustee in the liquidation of CDX Corporation (formerly known as Cadant). Also in connection with the acquisition, we issued options to purchase 2.0 million shares of our common stock and 250,000 shares of restricted stock to Cadant employees. We also agreed to issue up to 2.0 million additional shares of our common stock based upon the achievement of future sales targets through January 2003 for the CMTS product, which were not met.

Sale of ESP Consulting Services Product Line. On August 18, 2003, we sold our engineering consulting services product line, known as ESP, to an unrelated third party. The agreement involved the transfer of net assets of approximately $1.3 million, which included accounts receivable, fixed assets, an investment, and other assets attributable to the product line. Further, the transaction provided for the transfer of approximately 30 employees. Additionally, we incurred approximately $0.1 million of related closure costs, primarily legal and professional fees associated with the closing. We recognized a loss on the transaction of approximately $1.4 million during the third quarter 2003. The ESP product line contributed revenue of approximately $0.2 million and $1.3 million during the three and nine-month periods ended September 30, 2003, respectively, and revenue of $0.7 million and $2.5 million during the three and nine-month periods ended September 30, 2002, respectively. The ESP revenue is classified in the supplies product category. In accordance with the provisions of SFAS No. 144, Accounting for the Impairment

of Disposal of Long-Lived Assets, ESP is not reflected as a discontinued operation because it was determined to be an insignificant component of the Company's consolidated operations and assets.

Sale of Actives Product Line. On November 21, 2002, we sold our Actives product line, excluding receivables and payables, for $31.8 million in net proceeds. The agreement provided for the transfer of inventory and equipment attributable to the product lines, plus the transfer of approximately 34 employees. Total assets of approximately $20.3 million were disposed of, which included inventory, fixed assets, and other assets attributable to the product line. Additionally, we incurred approximately $7.3 million of related closure costs, including severance, vendor liabilities, professional fees, and other shutdown expenses. In connection with the sale, the Company recognized a gain of approximately $2.2 million in 2002. During the second quarter of 2003, the Company has reduced its accrual for vendor liabilities by $2.0 million as a result of settling for amounts less than originally anticipated. With this adjustment in the second quarter, the Company has now recognized a cumulative gain of approximately $4.2 million related to the sale of this discontinued operation.

Sale of Keptel Product Line. On April 24, 2002, we sold our Keptel product line. Keptel designed and marketed network interface systems and fiber optic cable management products primarily for traditional telecommunications residential and commercial applications. The transaction generated cash proceeds of $30.0 million. Additionally, we retained a potential earnout over a twenty-four month period based on sales achievements. The transaction also included a distribution agreement whereby we will continue to distribute Keptel products. Total assets of approximately $31.1 million were disposed of, which included inventory, fixed assets, intangibles (formerly classified as goodwill), and other assets. We incurred approximately $5.0 million of related closure costs, including severance, vendor liabilities, outside consulting fees, and other shutdown expenses. The net result of the transaction was a loss on the sale of the product line of approximately $6.1 million.

COST REDUCTION ACTIONS

During 2001 and 2002, we implemented significant cost reduction actions. In the third quarter of 2001, we concluded that it would be more cost effective to outsource manufacturing of our Actives and Keptel product lines. This resulted in the closure of four factories in Juarez, Mexico and El Paso, Texas. In conjunction with the purchase of Cadant, we closed our facility in Raleigh, North Carolina. The Raleigh location was a development facility where duplicative work to that being done by the Cadant organization was being performed. In 2001 and 2002, we continuously reviewed our cost structure with the goal of improving both our effectiveness and efficiency of operations. As a result, in October 2002, we announced the closure of our development and repair facility in Andover, Massachusetts and implemented other expense reduction actions including general reductions in force. These actions were, in part, facilitated by the simplification of our business model as a result of the closure of factories and product line rationalizations.

During the first three quarters of 2003, we undertook actions to further reduce our breakeven point. This included a reduction in workforce of a total of approximately 125 employees, as well as other cost saving measures.

INDUSTRY CONDITIONS

Our performance is largely dependent on capital spending for constructing, rebuilding, maintaining and upgrading broadband communications systems. After a period of intense consolidation and rapid capital expenditures within the industry through the fourth quarter of 2000, there was a tightening of credit availability throughout the telecommunications industry and a broad-based and severe drop in market capitalization for the sector. This caused broadband system operators to become more cautious in their capital spending, adversely affecting us and other equipment providers.

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 that several customers 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.

This industry downturn and other factors have adversely affected several of our largest customers. In September 2002, Adelphia Communications filed bankruptcy at a time when it owed us approximately $20.2 million in accounts receivable. As a result, we incurred a $20.2 million charge during the second quarter 2002, of which approximately $18.9 million was reflected in continuing operations and $1.3 million was reflected in discontinued operations.

As of November 12, 2003, Cabovisao, a Portugal-based customer owed us approximately 18.1 million euros in accounts receivable, after receiving a payment of approximately 0.6 million euros on August 7, 2003. A substantial portion of the accounts receivable balance is past due. This customer accounted for approximately 6% of our sales in 2002. Cabovisao and its parent company, Csii, are in the process of restructuring their financing. On June 30, 2003, Csii filed for court-supervised restructuring and recapitalization in Canada. We are continuing to monitor the progress of the financing efforts by Cabovisao and we are actively negotiating the settlement of the past due amount. ARRIS added approximately $6.4 million in incremental reserves for the Cabovisao receivable in the second quarter of 2003.

In the fourth quarter of 2002 Comcast completed its purchase of AT&T Broadband. Historically, AT&T Broadband had been our largest customer. AT&T Broadband, with the deployment of telephony as part of its core strategy, had been using our CBR telephony products in many of its major markets. Comcast had announced that its initial priority after its acquisition of AT&T Broadband was to emphasize video and high-speed data operations and focus on improving the profitability of its telephony operations rather than subscriber growth. As a result, we experienced a significant decline in sales of our constant bit rate, or CBR, telephony product to Comcast beginning in the fourth quarter of 2002 and continuing through 2003. However, this decline has been partially offset by an increase in CMTS C4 sales to Comcast.

SIGNIFICANT CUSTOMERS

A significant portion of ARRIS' revenue is derived from sales to Comcast and Cox Communications. Sales to these two customers for the three and nine-month periods ended September 30, 2003 and 2002 were as follows (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBE	
	2003	2002	2003	200
Comcast..................	$35,809	$89,548	$95,540	$215,2
% of sales...............	31.7%	49.6%	31.2%	40
Cox Communications.......	$29,801	$23,647	$74,748	$ 76,6
% of sales...............	26.3%	13.1%	24.4%	14

As described above, we have uncertainties surrounding our future transactions with Adelphia Communications and Cabovisao. Sales to these two customers for the three and nine-month periods ended September 30, 2003 and 2002 were as follows (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTE	
	2003	2002	2003	
Adelphia Communications.....	$4,109	$ 796	$10,875	$2

% of sales..................	3.6%	0.4%	3.6%	
Cabovisao...................	$ 107	$8,287	$ 617	$3
% of sales..................	0.1%	4.6%	0.2%	

COMPARISON OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

As the sale of our Actives and Keptel product lines in 2002 represented a majority of the transmission, optical and outside plant product category, we reclassified the results of these product lines to discontinued operations for all periods presented in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the

Impairment or Disposal of Long-Lived Assets. Our products and services are summarized in the following two product categories, broadband and supplies, instead of the previous three categories. The balance of the product lines previously reported in the former transmission, optical and outside plant product category have been combined with our supplies product category. All prior period amounts have been reclassified to conform to the new product categories.

Net Sales. Our sales for the third quarter 2003 decreased by 37.4% to $113.1 million as compared to the third quarter 2002 sales, but increased 11.2% sequentially from the sales recorded in the second quarter 2003. For the nine-month periods ended September 30, 2003 and 2002, net sales were $306.2 million and $529.5 million, respectively, a decrease of 42.2% year-over-year.

- Broadband product revenues decreased by $57.3 million or 43.3%, to $75.1 million in the third quarter 2003 as compared to the same quarter last year, but marked an increase of $8.6 million or 12.9%, from the previous quarter's sales of $66.5 million. The revenue growth in the third quarter 2003, as compared to the previous quarter, was primarily the result of increased sales to Cox Communications of our CBR telephony product line. Revenues for the first nine months of 2003 decreased approximately $167.4 million or 45.2%, to $203.2 million as compared to the same period in 2002. The significant decrease in broadband product revenue in 2003 as compared to 2002 is the result of several factors:

    - Sales to Comcast for constant bit rate ("CBR") telephony products declined by approximately $156.0 million. AT&T Broadband had been our largest customer of CBR telephony products. In the fourth quarter 2002, Comcast completed its purchase of AT&T Broadband. Comcast had announced that its initial priority after its acquisition of AT&T Broadband would be to emphasize video and high-speed data operations and focus on improving the profitability of its telephony operations rather than subscriber growth. As a result, our sales of CBR products to Comcast have decreased significantly in 2003. This decline has been partially offset by an increase in CMTS C4 sales to Comcast.

    - Broadband product revenue internationally declined by $65.6 million during the first nine months of 2003, as compared to the same period in 2002. A significant portion of this decline is attributable to the reduced purchases by Cabovisao, which accounted for approximately $36.0 million in broadband international revenue for the first nine months of 2002.

- Supplies product revenues decreased by approximately $10.1 million or 21.1%, to $38.1 million in the third quarter 2003 as compared to revenues of $48.2 million in the same quarter last year; however, third quarter 2003 marked an increase of $2.9 million or 8.2%, from the previous quarter's sales. The sequential quarter-over-quarter growth was predominantly due to the increase of cable modem sales during the third quarter 2003. Revenues for the first nine months of 2003 decreased $55.9 million or 35.2%, to $102.9 million as compared to the first nine months of 2002. The year-over-year decrease for the first nine months of the year in supplies product revenue is the result of several factors:

    - Sales of power supplies related to CBR products declined as a direct result of the significant decrease in Comcast's purchases of telephony products, as described above. Consolidated power supply revenue for the first nine months of 2003 was $0.2 million, as compared to revenue of $15.2 million for the same period in 2002.

    - Revenues have been significantly impacted by the decline in shipments to Adelphia, which filed for bankruptcy during the second quarter of 2002. The bankruptcy filing by Adelphia and the resulting reduced sales to Adelphia accounted for approximately $7.9 million of the overall decrease in supplies product revenue year-over-year.

    - A general slowdown in MSO's infrastructure spending contributed to the remaining decrease in supplies revenue year-over-year.

International sales decreased by approximately $16.5 million or 48.5%, to $17.5 million for the three months ended September 30, 2003 as compared to the same quarter in 2002, and marked a decrease of $0.3 million or 1.7%, when compared to the previous quarter's international sales. International sales for the nine months ended September 30, 2003 decreased $67.0 million or 55.4%, to $54.0 million as compared to sales recorded during the same period in 2002. The reduced level of international business is reflective of the tight capital spending market, coupled with the

situation with Cabovisao, as previously discussed. Cabovisao accounted for approximately $36.0 million or 54%, of the decrease in total international revenues. We have halted shipments to Cabovisao until its restructuring status is clarified.

Gross Profit. Gross profit decreased by $33.4 million or 51.2%, to $31.8 million in the third quarter 2003, as compared to the third quarter 2002, but marked an increase of $4.6 million or 17.1% sequentially over the previous quarter. Gross profit margins for the quarter ended September 30, 2003 decreased approximately 7.9 percentage points to 28.2% as compared to the same quarter of 2002. Gross profit for the nine months ended September 30, 2003 was 27.4%, as compared to 34.7% for the first nine months 2002. This reduction in gross margin reflects two primary factors:

- The reduction in sales volume of approximately $223.3 million during the first nine months of 2003, as compared to the same period in 2002, provided a lower base to cover our fixed costs leading to a reduction in our gross margin percentage.

- Our gross margin within the broadband product category declined as a result of a shift in product mix. Specifically, we sold less constant bit rate telephony equipment in 2003 as compared to 2002.

During the first nine months of 2003, we recorded severance charges of $0.4 million, as compared to severance of $1.0 million recorded during the same period in 2002. Also impacting gross margins during 2002 was a charge of $2.1 million to write off the balance of the power product line inventory. This product line was sold in late 2001.

Selling, General and Administrative and Development ("SGA&D") Expenses. SGA&D expenses decreased by approximately $11.0 million or 24.0% to $35.1 million during the third quarter 2003 as compared to the third quarter 2002. SGA&D expenses for the nine months ended September 30, 2003 decreased by $45.6 million or 28.2%, to $116.0 million, as compared to the same period in 2002. This significant decrease in SGA&D expenses for the first nine months of the year is the result of several factors:

- Expenses related to our provision for doubtful accounts decreased by approximately $14.9 million for the nine months ended September 30, 2003, as compared to 2002. This decrease was primarily due to the reserve of $14.9 million recorded for our Adelphia accounts receivable in 2002.

- The elimination of the Nortel Networks' agency fee in 2003 accounted for approximately $10.6 million of the year-over-year decrease. The agreement with Nortel Networks for international agency fees terminated in December 2002.

- The remaining decrease of approximately $20.1 million was a result of the overall reduced employee levels, the closure of our Andover facility, and aggressive operating expense management. Further, the first nine months of 2003 reflects a reduction in bonus accruals as compared to the same period in 2002.

Restructuring and Impairment Charges. In the first quarter of 2003, we evaluated the restructuring accruals related to previously closed facilities within our broadband product category. Upon review, we recorded an additional restructuring charge of $0.3 million during the first quarter as a result of a change to the initial estimates used. During the first nine months of 2002, no restructuring charges were recorded related to continuing operations.

Amortization of Intangibles. Intangibles amortization expense for the three-month periods ended September 30, 2003 and 2002 was $8.8 million and $8.7 million, respectively. Intangibles amortization expense for the year-to-date periods ended September 30, 2003 and 2002 was $26.3 million and $25.8 million, respectively. The majority of our intangibles 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, and the Com21 acquisition in the third quarter 2003.

Interest Expense. Interest expense for the quarters ended September 30, 2003 and 2002 was $2.9 million and $2.1 million, respectively. Interest expense for the first nine months of 2003 was $7.5 million, as compared to $6.5 million recorded during the same period in 2002. Interest expense for all periods reflects the cost of borrowings on our revolving line of credit, amortization of deferred finance fees, and the interest paid on our convertible

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subordinated notes and capital leases. As of September 30, 2003 and 2002, we did not have a balance outstanding under our credit facility.

Membership Interest Expense. In conjunction with the acquisition of Arris Interactive L.L.C., we issued to Nortel Networks a subordinated redeemable Class B membership interest in Arris Interactive with a face amount of $100.0 million. This membership interest earned a return of 10% per annum, compounded annually. During the first quarter 2003, we redeemed the entire Class B membership interest in Arris Interactive held by Nortel Networks, at a discount, and, therefore, the membership interest ceased. For the three-month periods ended September 30, 2003 and 2002, we recorded membership interest expense of $0 and $2.7 million, respectively. For the nine-month periods ended September 30, 2003 and 2002, we recorded membership interest expense of $2.4 million and $7.7 million, respectively.

Gain on Debt Retirement. During the first quarter 2003, ARRIS redeemed the entire Class B membership interest in Arris Interactive held by Nortel Networks for approximately $88.4 million. This discounted redemption resulted in a gain of approximately $28.5 million during the first quarter of 2003.

During the second quarter 2002, we exchanged 1,593,789 shares of our common stock for approximately $15.4 million of the convertible subordinated notes due 2003. The exchanges were recorded in accordance with SFAS No. 84, Induced Conversions of Convertible Debt, which requires the recognition of an expense equal to the fair value of additional shares of common stock issued in excess of the number of shares that would have been issued upon conversion under the original terms of the notes. As a result, in connection with these exchanges, we recorded a non-cash loss of approximately $8.7 million, based upon a weighted average common stock value of $9.10 (as compared with a common stock value of $24.00 per share in the original conversion ratio for the notes). In connection with the exchanges, we also incurred associated fees of $0.6 million, resulting in an overall net loss of $9.3 million.

Loss on Investments. We held certain investments in the common stock of publicly traded companies totaling approximately $0.1 million at September 30, 2002 which were classified as trading securities; the shares of common stock were sold during the third quarter 2003 and the balance was $0 at September 30, 2003. Changes in the market value of these securities and gains or losses on related sales of these securities were recognized in income and resulted in net pre-tax loss of approximately $7 thousand and $83 thousand during the third quarter 2003 and 2002, respectively. During the nine months ended September 30, 2003, we recognized a pre-tax gain of $0.1 million as compared to a pre-tax loss of $0.7 million during the same period of 2002.

We hold certain investments in the common stock of publicly traded companies totaling approximately $1.4 million at both September 30, 2003 and 2002, which are classified as available for sale. Changes in the market value of these securities are recorded in other comprehensive income. These securities are also subject to a periodic impairment review, which requires significant judgment.

In addition, we hold a number of non-marketable equity securities totaling approximately $1.0 million and $11.0 million at September 30, 2003 and 2002, respectively, which are classified as available for sale. Pursuant to the terms of the definitive agreement of the ESP divestiture, an investment totaling approximately $0.8 million was transferred to the buyer. The non-marketable equity securities are subject to a periodic impairment review, which requires significant judgment as there are no open-market valuations. During the second quarter 2003, we recorded a charge of approximately $1.1 million in relation to the impairment of the carrying value of an investment in a start-up company, which raised a new round of financing at a substantial discount in early July 2003. During the second quarter 2002, we wrote off a $1.0 million investment in a technology start-up company, as it was unable to raise further financing and filed for bankruptcy during the second quarter 2002.

Gain in Foreign Currency. During the third quarter 2003, we recorded a foreign currency gain of approximately $0.2 million, as compared to a foreign currency gain of $0.3 million for the third quarter 2002. The first nine months of 2003 included a foreign currency gain of approximately $2.2 million, as compared to a gain of $4.2 million for the first nine months of 2002. The foreign currency gains are primarily driven by the fluctuation of the value of the euro, as compared to the U.S. dollar, as we have several European customers whose receivables and collections are denominated in euros.

Other Expense (Income). Other expense (income) for the three-month periods ended September 30, 2003 and 2002 was $(0.1) million and $0.1 million, respectively. Other expense (income) for the nine-month periods ended September 30, 2003 and 2002 was $(0.2) million and $0.3 million, respectively. The other expense (income) for all periods was primarily related to interest income and bank charges.

Income Tax (Benefit) Expense. During the first quarter 2002, we recorded an income tax benefit of $6.8 million as a result of a change in tax legislation, allowing us to carry back losses for five years versus the previous limit of two years. As we are in a cumulative loss position for tax purposes, we did not incur income tax expense (benefit) during the subsequent periods.

Discontinued Operations. In 2002, ARRIS sold the Keptel and Actives product lines, which have been accounted for as discontinued operations in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. As a result, these two product lines and historical results have been reclassified accordingly for all periods presented. Revenues from the discontinued operations were $17.0 million and $53.8 million, respectively, for the three and nine-month periods ended September 30, 2002. The net loss from discontinued operations, net of taxes, for the three and nine-month periods ended September 30, 2002 was $(1.4) million and $(20.5) million, respectively.

Cumulative Effect of an Accounting Change - Goodwill. We adopted SFAS No. 142, Goodwill and Other Intangible Assets, on January 1, 2002. Under the transitional provisions of SFAS No. 142, we recorded a goodwill impairment loss of approximately $(58.0) million. The impairment loss has been recorded as a cumulative effect of a change in accounting principle on the accompanying Consolidated Statement of Operations for the nine months ended September 30, 2002.

LIQUIDITY AND CAPITAL RESOURCES

Financing

We have in place an asset-based revolving credit facility permitting us to borrow up to $92.5 million (which can be increased under certain conditions by up to $25.0 million), based upon availability under a borrowing base calculation. In general, the borrowing base is limited to 85% of net eligible receivables (with a cap of $5.0 million in relation to foreign receivables), subject to a reserve of $10.0 million. In addition, upon obtaining appropriate asset appraisals, we may include in the borrowing base calculation 80% of the orderly liquidation value of net eligible inventory (not to exceed $60.0 million). The facility contains traditional financial covenants, including fixed charge coverage, senior debt leverage, minimum net worth, and minimum inventory turns ratios. The facility is secured by substantially all of our assets. The credit facility has a maturity date of August 3, 2004. The commitment fee on unused borrowings is 0.75%.

The credit facility was amended in January 2003 to provide that the minimum net worth covenant applied only to the period prior to December 31, 2002. In March 2003, we amended our credit facility to permit us to issue up to $125.0 million of the Notes due 2008, to use the proceeds of such notes as described above. The amendment also reduced the revolving loan commitments by $10.0 million to $115.0 million. The credit facility was further amended in August 2003 to reduce the aggregate revolving loan commitments to $92.5 million and to waive the fixed charge coverage ratio for the third and fourth quarters of 2003. In conjunction with obtaining the waiver, the financial covenants were expanded to include EBITDA covenants for the third and fourth quarters of 2003. The EBITDA covenant for the third quarter 2003 was met and we anticipate meeting the covenant in the fourth quarter.

As of September 30, 2003, we had no borrowings outstanding under our credit facility (and have not had any outstanding balances under the facility for the past eight quarters), and had approximately $7.0 million outstanding under letters of credit. We had approximately $47.1 million of available capacity. We were in compliance with all covenants mandated by the credit facility, including:

	Requirement	Level at September
Maximum senior leverage ratio	1.25	-0-
Minimum fixed charge coverage ratio (1)	N/A	N/A
Minimum inventory turns	2.3	3.1
Maximum capital expenditures (annual)	$ 30.0 million	$4.2 million
Minimum EBITDA (2)	$(3.0) million	$2.3 million

(1) Obtained waiver for third and fourth quarters of 2003. The requirement beginning with the first quarter 2004 will be a minimum ratio of 1.5.

(2) Applicable only to the third and fourth quarters of 2003. The requirement for the fourth quarter 2003 is a minimum of $3.0 million.

Cash Flow

Operating activities used cash of $12.1 million during the first nine months of

2003. A net loss used $(38.9) million in cash flow during 2003. Other non-cash items such as depreciation, amortization, provisions for doubtful accounts, a loss on disposal of fixed assets, a loss on disposal of product line, and a loss on investments accounted for positive adjustments of approximately $55.6 million during 2003. A gain on the retirement of debt and a gain on the sale of a discontinued product line accounted for adjustments to net income of $(30.5) million. A net decrease of $1.8 million in operating assets and liabilities was primarily comprised of decreases in accounts receivable and inventory, which were offset with a decrease in accounts payable and accrued liabilities. Operating activities provided cash of approximately $66.1 million during the first nine months of 2002. A net loss used $(97.1) million in cash flow during this period. Other non-cash items such as depreciation, amortization, provisions for doubtful accounts, losses on investments, a loss on debt retirement, a loss on the sale of a discontinued product line, and cumulative effect of an accounting changes accounted for positive adjustments of approximately $150.4 million during the first nine months of 2002. A net decrease of $12.8 million in operating assets and liabilities was primarily comprised of decreases in other receivables and inventory, which were offset with an increase in accounts receivable and a decrease in accounts payable and accrued liabilities. We continue to have a strong focus on working capital management, particularly in the areas of accounts receivable and inventory. Our days sales outstanding improved from 65 days to 47 days from the third quarter 2002 to the third quarter 2003. Our inventory levels decreased by approximately $9.0 million to $95.0 million from the third quarter 2002 to third quarter 2003.

Cash flows used by investing activities were approximately $5.4 million for the nine months ended September 30, 2003 as compared to cash flows provided of $22.6 million during the same period in 2002. The investments made during 2003 included $4.2 million related to capital expenditures, approximately $2.8 million related to the Atoga Systems' and Com21 acquisitions, and $0.2 million of costs associated with the disposal of our ESP product line. These expenditures were partially offset with the final proceeds of $1.8 million related to the sale of the Actives product line. The investments during 2002 included $6.5 million spent on capital assets and approximately $0.9 million for fees related to the Cadant acquisition, offset with proceeds of $30.0 million related to the sale of the Keptel product line.

Cash flows used in financing activities were $20.9 million for the first nine months of 2003. Proceeds from the issuance of debt provided $126.6 million in cash, and proceeds from the issuance of common stock provided $1.2 million. These cash inflows were offset with a cash use of approximately $88.4 million to redeem the Nortel Networks membership interest, $28.0 million used to repurchase and retire 8 million shares of common stock held by Nortel Networks, and $24.3 million used for payments on debt obligations. Other uses of cash included payments on capital lease obligations and deferred financing activities of $2.1 million and $5.8 million, respectively. Cash flows in financing activities for the first nine months of 2002 were relatively flat, with proceeds from issuance of common stock of approximately $1.0 million offset by capital lease payments and deferred finance fees paid of $0.7 million and $0.3 million, respectively.

Based upon current levels of operations, we expect that sufficient cash flow will be generated from operations so that, combined with cash on hand and other financing alternatives available, including bank credit facilities, we will be able to meet all of our current debt service, capital expenditure and working capital requirements.

Foreign Currency

A significant portion of our products are manufactured or assembled in Mexico, the Philippines, 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. Beginning in 2002, we implemented a hedging strategy to mitigate the monetary exchange fluctuations from the time of invoice to the time of payment, and have entered into forward contracts based on a percentage of expected foreign currency receipts. The percentage can vary, based on the predictability of cash receipts. We regularly review our accounts receivable in foreign currency and purchase additional forward contracts when appropriate. As of September 30, 2003, we did not have any forward contracts outstanding. During the second quarter 2003, we purchased a 5.0 million euro put contract with an expiration of October 31, 2003. The contract was purchased as part of our internal hedging strategy to reduce the risk associated with our euro receivables. The contract was purchased for approximately $174 thousand and the cumulative fair value adjustment as of September 30, 2003 was a loss of approximately $139 thousand which is included in the loss in foreign currency in the Consolidated Statements of Operations.

Financial Instruments

In the ordinary course of business, we, from time to time, will enter into financing arrangements with our vendors and customers. These financial instruments include letters of credit, commitments to extend credit and guarantees of debt. These agreements could include the granting of extended payment terms that result in longer collection periods for accounts receivable and slower cash inflows from operations and/or could result in the deferral of revenue. As of September 30, 2003, we had approximately $7.0 million outstanding under letters of credit with our banks.

Investments

In the ordinary course of business, we may make strategic investments in the equity securities of various companies, both public and private. We held certain investments in the common stock of publicly traded companies, which were classified as trading securities; the shares of common stock were sold during the third quarter 2003 and the balance was $0 at September 30, 2003. Changes in the market value of these securities and gains or losses on related sales of these securities were recognized in income and resulted in net pre-tax losses of approximately $7 thousand and $83 thousand during the third quarter 2003 and 2002, respectively. During the nine months ended September 30, 2003, we recognized a pre-tax loss of $0.1 million as compared to a pre-tax loss of $0.7 million during the same period of 2002.

We hold certain additional investments in the common stock of publicly traded companies totaling approximately $1.4 million at September 30, 2003, which are classified as available for sale. In addition, we hold a number of non-marketable equity securities totaling approximately $1.0 million, which are classified as available for sale. At September 30, 2003, we had unrealized losses related to these available for sale securities of approximately $0.3 million included in comprehensive income.

We offer a deferred compensation arrangement, which allows certain employees to defer a portion of their earnings and defer the related income taxes. These deferred earnings are invested in a "rabbi trust," and are accounted for in accordance with Emerging Issues Task Force 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 events (other than bankruptcy). The investment in the rabbi trust is classified as a current asset on our balance sheet. At September 30, 2003, we had a cumulative unrealized gain related to the rabbi trust of approximately $0.5 million included in comprehensive income.

Capital Expenditures

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS' capital expenditures were $1.6 million and $4.2 million for the three and nine months, respectively, ended September 30, 2003, as compared to $2.9 million and $6.5 million for the same periods in 2002. We had no significant commitments for capital expenditures at September 30, 2003. Management expects to invest approximately $6.0 million in capital expenditures for the year 2003.

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, constitute forward-looking statements with respect to the financial condition, results of operations, and business of ARRIS, including statements that are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and management's beliefs and assumptions regarding these markets. In this report, these statements include, among others, statements regarding the impact of acquisitions and divestitures, future amounts of capital expenditures, and estimates of contractual commitments. 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;
- regulations;
- demands for network services;
- competition and technology; and
- real or perceived trends or uncertainties in these factors.

Developments in the industry and in the capital markets over the past two 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 under bankruptcy since the September 2002. Even if the financial health of that company and other customers improve, 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, Adelphia's bankruptcy filing has further heightened concerns in the financial markets about the domestic cable industry. This 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.

DEVELOPMENTS RELATING TO CABOVISAO MAY ADVERSELY AFFECT OUR BUSINESS AND RESULTS OF OPERATIONS.

Cabovisao, a Portugal-based MSO, accounted for approximately 6% of our total sales in 2002. As of November 12, 2003, Cabovisao owed us approximately 18.1 million euros in accounts receivable. Cabovisao and its parent company, Csii, are in the process of restructuring their financing. On June 30, 2003, Csii filed for court-supervised restructuring and recapitalization in Canada. We are continuing to monitor the progress of the financing efforts by Cabovisao and we are actively negotiating the settlement of the past due amount. ARRIS added approximately $6.4 million in incremental reserves for the Cabovisao receivable in the second quarter of 2003. We will not deliver further products to Cabovisao until we have a satisfactory payment plan with Cabovisao and are considering what actions should be taken regarding the situation. We cannot assure you that Cabovisao will pay us according to a schedule, if at all, or that we will make any sales to Cabovisao in the future.

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 us with broader product lines, which may enable them to bundle more products in customer offerings than us. Our major competitors include:

- ADC Telecommunications, Inc.;
- Broadband Services, Inc.;
- Cisco Systems, Inc.;
- Motorola, Inc.;
- Riverstone Networks, Inc.;
- Scientific-Atlanta, Inc.;
- Tellabs, Inc.;
- Terayon Communications Systems, 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 providers. We may not be able to compete successfully in the future, and competition may harm our business.

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 two largest customers are Comcast (primarily through the recently acquired AT&T Broadband business) and Cox Communications. For the nine months ended September 30, 2003, sales to Comcast accounted for approximately 31.2 % of our total revenues, while sales to Cox Communications accounted for approximately 24.4%. We currently are the exclusive provider of telephony products for both Cox Communications and, in eight metro areas, Comcast, as successor to AT&T Broadband. In addition, we have one other customer who accounted for more than 5% each of our total revenues for the first nine months of 2003. The loss of Cox Communications, Comcast, or any of our other large customers, or a significant reduction in the services provided to any of them would have a material adverse impact on our business. In addition, as a result of the merger of Comcast with AT&T Broadband in late 2002, we have experienced interruptions in purchasing by the resulting Comcast entity in 2003. Comcast has announced that its initial priority after its acquisition of AT&T Broadband will be to emphasize video and high-speed data operations and focus on improving the profitability of its telephony operations at the expense of subscriber growth. As a result, we experienced a significant decline in sales of our CBR telephony product to Comcast in the fourth quarter of 2002, which has continued into 2003.

OUR CREDIT FACILITY IMPOSES FINANCIAL COVENANTS THAT MAY ADVERSELY AFFECT THE REALIZATION OF OUR STRATEGIC OBJECTIVES.

We and certain of our subsidiaries have entered into a revolving credit facility providing for borrowing up to a committed amount of $92.5 million, with borrowing also limited by a borrowing base determined by reference to eligible accounts receivable and, subject to certain conditions, eligible inventory. As of September 30, 2003, the borrowing base was $47.1 million. The credit facility imposes, among other things, covenants limiting the incurrence of additional debt and liens and requires us to meet certain financial objectives. The credit facility has a maturity date of August 3, 2004. As of November 12, 2003, we had no borrowings outstanding under the credit facility. Any acceleration of the maturity date of the credit facility could have a material adverse effect on our business.

WE HAVE SIGNIFICANT STOCKHOLDERS THAT MAY NOT ACT CONSISTENTLY WITH THE INTERESTS OF OUR OTHER STOCKHOLDERS.

As of November 12, 2003, Nortel Networks owned approximately 18.6% of our common stock and Liberty Media Group beneficially owned approximately 10.2% of our common stock. These respective ownership interests result in both Nortel Networks and Liberty Media having a significant influence over us. Nortel Networks and Liberty Media may exert their respective influences or sell their respective shares at a time or in a manner that is inconsistent with the interests of our other stockholders. Any sales of substantial amounts of our common stock in the public market, or the perception that such sales might occur, could have a depressive effect on the market price of our common stock.

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 poison pill 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 currently under development by us may not be successfully developed. Even if products under development are successfully completed, 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 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. We and one or more of our competitors may each supply products to businesses that have merged, such as AT&T Broadband and Comcast, or will merge in the future. Consolidations could result in delays in purchasing decisions by the merged businesses, and we could play either a greater or lesser role in supplying the communications products to the merged entity. These purchasing decisions of the merged companies could have a material adverse effect on our business. For example, we experienced delays while the Comcast and AT&T Broadband deal was pending, and have experienced slowdowns since the transaction was completed. 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.

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, 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.

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 PRODUCTS ARE MANUFACTURED.

A significant portion of our products are manufactured or assembled in Mexico and the Philippines and other countries outside of the United States. The governments of the foreign countries in which we have plants 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 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 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 payments without exchanging the notional principal amount. During the quarter ended September 30, 2003, we did not have any outstanding interest rate swap agreements.

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

We have certain international customers who are billed in their local currency.

Changes in the monetary exchange rates may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The euro is the predominant currency of those customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the euro versus the dollar, a hypothetical 10% weakening of the U.S. dollar (as of September 30, 2003) would provide a gain on foreign currency of approximately $1.7 million. Conversely, a hypothetical 10% strengthening of the U.S. dollar would provide a loss on foreign currency of approximately $1.7 million. As of September 30, 2003, we had no material contracts, other than accounts receivable, denominated in foreign currencies.

We regularly review our accounts receivable in foreign currency and purchase forward contracts when appropriate. As of September 30, 2003, we had no foreign currency forward contracts outstanding. During the second quarter 2003, we purchased a 5.0 million euro put contract with an expiration of October 31, 2003. The contract was purchased as part of our internal hedging strategy to reduce the risk associated with our euro receivables. The contract was purchased for approximately $174 thousand and the cumulative fair value adjustment as of September 30, 2003 was a loss of approximately $139 thousand.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to our company (including our consolidated subsidiaries) required to be included in our reports filed or submitted under the Exchange Act.

(b) Changes in Internal Controls. Since the Evaluation Date, there have not been any significant changes in our internal controls or in other factors that could significantly affect such controls.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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

Reports on Form 8-K

FILING DATE	ITEMS REPORTED
07-24-03	Item 5 and Item 7
08-05-03	Item 5
09-09-03	Item 5 and Item 7

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/ Lawrence A. Margolis

Lawrence A. Margolis
Executive Vice President,
Chief Financial Officer

Dated: November 14, 2003