ARRIS GROUP INC
Form 10-K
March 12, 2004

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

For the fiscal year ended December 31, 2003

of

ARRIS GROUP, INC.

A Delaware Corporation
IRS Employer Identification No. 58-2588724
SEC File Number 000-31254

11450 Technology Circle

Duluth, GA 30097
(678) 473-2000

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common stock, $0.01 par value
Preferred Stock Purchase Rights

ARRIS Group (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 is unaware of any delinquent filers pursuant to Item 405 of Regulation S-K.

ARRIS Group, Inc. is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

The aggregate market value of ARRIS Group s Common Stock held by non-affiliates as of June 30, 2003 was approximately $301.3 million (computed on the basis of the last reported sales price per share of such stock of $4.96 on the Nasdaq National Market System). As of March 9, 2004, 86,695,957 shares of the registrant s Common Stock were outstanding. For these purposes, directors, officers and 10% shareholders have been assumed to be affiliates.

Portions of ARRIS Group s Proxy Statement for its 2004 Annual Meeting of Stockholders are incorporated by reference into Part III.

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PART I

Item 1. *Business*

As used in this Annual Report, we, our, us, the Company, and ARRIS refer to Arris Group, Inc. and our consolidated subsidiaries witho limitation, including Arris International, Inc. (formerly ANTEC Corporation) and Arris Interactive L.L.C, unless the context otherwise requires.

General

Our principal executive offices are located at 11450 Technology Circle, Duluth, Georgia 30097, and our telephone number is (678) 473-2000. We also have a worldwide website at *http://www.arrisi.com.* On our website we provide hyperlinks to copies of the annual, quarterly and current reports we file with the Securities and Exchange Commission, any amendments to those reports, and all press releases. We also maintain the following documents on our website:

- Code of Ethics (applicable to all employees), and our Financial Code of Ethics (applicable to our CEO, senior financial officers, and all finance, accounting, and legal managers). The website also will disclose whether there have been any amendments or waivers to the Code of Ethics and Financial Code of Ethics.
- Audit Committee Charter
- Compensation Committee Charter
- Nominating and Corporate Governance Committee Charter

We will provide copies of these documents in electronic or paper form upon request to Investor Relations, free of charge.

Industry Overview

We develop and supply equipment and technology for cable system operators and other broadband service providers which allow them to deliver a full range of integrated voice, video and data services to their subscribers. Further, we are a leading supplier of infrastructure products used by cable system operators in the build-out and maintenance of hybrid fiber-coaxial, or HFC, networks. We provide our products and equipment principally to the cable television market and, more specifically, to operators of multiple cable systems, or MSOs. In recent years, the technology used in cable systems has evolved significantly. Historically, cable systems offered only one-way video service. Due to technological advancements and large investments in infrastructure upgrades, these systems have evolved to become two-way broadband systems featuring high-speed, high-volume, interactive services. MSOs have aggressively upgraded their networks to cost-effectively support and deliver enhanced video, voice and data services. As a result, cable operators have been able to use broadband systems to increase their revenues by offering enhanced interactive subscriber services, such as high-speed data, telephony, digital video and video on demand, and to effectively compete against other broadband communications technologies, such as digital subscriber line, local multiport distribution service, direct broadcast satellite, fiber to the home, and fixed wireless. Delivery of enhanced services also has helped MSOs offset slowing basic video subscriber growth, reduce their subscriber churn and compete against alternative providers, in particular, digital broadcast satellite, or DBS.

A key factor supporting the growth of broadband systems is the powerful growth of the internet. Rapid growth in the number of internet users and the demand for high-speed, high-volume interactive services has created demand for high-speed internet access at home. Another key factor supporting the growth of broadband systems is the evolution of video services being offered to consumers. Video on demand and high definition television are two key video services expanding the use of MSOs broadband systems. The increase in volume and complexity of the signals transmitted through the network has continually pushed broadband system operators to deploy new technologies as they evolve. Further, system operators are looking for products and technology that are flexible, cost effective, easily deployable and scalable to meet future demand and mix

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of services. Because the technologies are evolving and the signals are growing in complexity and volume, broadband system operators need equipment that provides the necessary technical capacity at a reasonable cost at the time of initial deployment and the flexibility to accommodate expansion and technological advances. We believe that our products position us well to meet these industry challenges.

Capital spending by MSOs on their networks has shifted in the past several years. The table below illustrates the shifting mix of capital spending by US MSOs:

MSO Capital Expenditure Forecast 2000-2006E ($B)

(Source: Kagan 2003, Morgan Stanley Estimates, April 2002)

As can be seen from the above table:

Spending on HFC rebuilds and upgrades has declined and is expected to decline further.

Spending on maintenance and extension is expected to increase, particularly as the newly built plant ages.

Spending on new services (digital video, telephony, high-speed data) has and is expected to increase.

Two of the fastest growing services are cable telephony and high-speed data. The data below is taken from both external sources and internal estimates and illustrates the expected growth in subscribers for these two services:

Worldwide Cable Telephony Subscribers

Feb 2004 ARRIS Estimate; Sources: IN-STAT Nov 2003, Kagan Feb 2004, Yankee Jul 2003

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Cable Modem Unit Sales Worldwide

(Source: ARRIS Feb 2004 Estimate based on Cable Datacom News, Infonetica)

Cable telephony allows cable operators to offer their customers local and long distance residential telephone service. It is presently offered to cable operators using two distinct technologies: constant bit rate, or CBR, technology and Internet Protocol, or IP, technology. CBR technology utilizes the switched-circuit technology currently used in traditional phone networks. This is a proven carrier-class telephony solution that enables operators to directly compete with incumbent telephone carriers with voice services and class-features, which include caller ID, call-waiting and three-party conferencing. At the end of 2003, our Cornerstone® CBR cable telephone products served over 4 million subscriber lines deployed by 56 operators in 102 cities in thirteen countries. IP technology, also known as Voice over IP, or VoIP, permits cable operators to provide toll-quality cable telephony at costs below those associated with CBR technology. VoIP technology has been deployed by several system operators throughout the world and is being tested in trials being conducted by other system operators. We offer telephony products using both of these technologies.

Data and VoIP services are governed by a set of technical standards promulgated by CableLabs® in North America and tComLabs in Europe, two industry standard-setting bodies. While the standards set by these two bodies necessarily differ in a few details to accommodate the differences in HFC network architectures between North America and Europe, they have a great deal in common. The primary data standard specification for cable operators in North America is entitled Data Over Cable Service Interface Specification , or DOCSIS®. Release 1.1 of this specification has been the governing standard for data services in North America. The Euro-DOCSIS standard Release 1.1 is the same for Europe. A new version of the standard, DOCSIS 2.0, was released in 2001, and suppliers began delivering products compliant to this new standard in 2003 and will be offering more in 2004. DOCSIS 2.0 builds upon the capabilities of DOCSIS 1.1 and adds additional throughput in the upstream portion of the cable plant from the consumer out to the Internet. In addition to the DOCSIS standards which govern data transmission, CableLabs has defined the PacketCable® standard for VoIP. This standard defines the interfaces among network elements such as cable modem termination systems, or CMTS, multi-media terminal adapters, or MTA, gateways and call management servers to provide high quality IP telephony service over the HFC network.

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A broadband system consists of three principal components:

Headend. The headend is a central point in the cable system where signals are received via satellite and other sources and interfaces are located that connect the Internet and public switched telephony networks. The headend facility organizes, processes and retransmits those signals through the distribution network to subscribers.

Distribution Network. The distribution network consists of fiber optic and coaxial cables and associated optical and electronic equipment that allocates the combined signals from the headend and transmits them throughout the cable system to nodes.

Subscriber Premises. Cable drops extend from nodes to subscribers homes and connect to a subscriber s television set, converter box, telephony network interface device or computer modem.

Our Principal Products

We provide cable system operators with a comprehensive product offering that meets their end-to-end needs, from headend to subscriber premises. We divide our product offerings into two categories:

Broadband:	Cable telephony products, CBR telephony products (headend and network interface units, or NIUs) and VoIP telephony products (headend)
	High-speed data products, including DOCSIS headend equipment
	Operational support systems
	System integration services, and
	Metro and regional optical transport equipment
Supplies:	Infrastructure products for fiber optic or coaxial networks built under or above ground, including cable and strand, vaults, conduit, drop materials, tools, and test equipment
	Cable modems and embedded multimedia terminal adapters, or E-MTAs

Voice over IP and Data Products

Headend The heart of a voice over IP headend is a cable modem termination system, or CMTS. A CMTS, along with a call agent, a gateway, and provisioning systems provide the ability to integrate the public-switched telephone network and high-speed data services over an HFC network. The CMTS provides the software and hardware to allow the IP traffic from the Internet or that used in VoIP telephony to be converted for use on HFC networks. It is also responsible for initializing and monitoring all cable modems connected to the HFC network. We provide three products that are used in the cable operator s headend to provide VoIP and high-speed data services to residential or business subscribers. These are the Cornerstone Data CMTS 1500, the Cadant® C4 CMTS, and the Cadant C3 CMTS:

The Cadant C4 CMTS is a high density, chassis-based product that provides the industry s most flexible built-in redundancy to ensure carrier-grade performance. It is PacketCable 1.0, DOCSIS 1.1 and Euro-DOCSIS 1.1 qualified and will support recently released DOCSIS 2.0 and Euro-DOCSIS 2.0 standards. Each chassis supports up to 32 downstream channels and 128 upstream channels making it one of the highest density scaleable headend products currently available. It can provide high-speed data and VoIP services in headends that service thousands to hundreds of thousands of subscribers.

The Cadant C3 CMTS is a rack mounted, single downstream-based product that provides high performance packet handling in an extremely compact package. It is DOCSIS 1.1 and Euro-DOCSIS 1.1 qualified and will support recently released DOCSIS 2.0 and PacketCable standards.

Each unit supports one downstream channel and up to 6 upstream channels with a selectable choice of modulation schemes. The C3 supports markets worldwide with DOCSIS, Euro-DOCSIS and Japanese DOCSIS parameters that are selectable via software.

The Cornerstone CMTS 1500 is a DOCSIS 1.1 and Euro-DOCSIS 1.1 qualified CMTS. It is a scalable headend solution, providing high-speed data and voice service in headends that service several thousand to 50,000 subscribers.

Subscriber Premises Subscriber premises equipment includes DOCSIS 1.0, 1.1, and 2.0 Certified cable modems for high-speed data applications as well as Euro-DOCSIS certified versions and PacketCable Certified E-MTAs for VoIP applications in both DOCSIS and Euro-DOCSIS networks. The PacketCable solution builds on DOCSIS 1.1 and its quality of service enhancements to support lifeline telephony deployed over HFC networks. The Touchstone™ product line provides carrier-grade performance to enable operators to provide all data, telephony and video services on the same network using common equipment. The Touchstone product line consists of the Touchstone 300-series and 450-series of cable modems, the Touchstone 202-series and 402 series of telephony modems for indoor applications and the Touchstone Telephony Port 204 for outdoor deployments.

The Touchstone CM300A Cable Modem is DOCSIS 1.1 certified enabling it to be deployed in networks where advanced high-speed data features such as tiered data services are planned. The Touchstone 300B Cable Modem provides the same features as the CM300A but is Euro-DOCSIS certified for use in European and similar systems. The Touchstone CM450A Cable Modem is DOCSIS 2.0 certified which gives operators the potential to offer much higher upstream data rates. DOCSIS 2.0 is backward compatible with DOCSIS 1.0 and 1.1 headend systems. The Touchstone 450B Cable Modem provides the same features as the CM450A but is Euro-DOCSIS certified. ARRIS also manufactures cable modems that have been homologated in other countries, including Chile, Argentina, Israel, Australia, Hong Kong, and Korea.

The Touchstone TM202A E-MTA is a PacketCable and DOCSIS 1.1 indoor E-MTA that supports enhanced services of high-speed data and up to two lines of IP telephony in a single unit. The TM202A s innovative, compact design provides for easy installation. This product is also available in a Euro-DOCSIS design, the Touchstone TM202B, as well as one designed specifically for the unique frequency plan of Japanese cable systems, the Touchstone TM202C. The Touchstone TM202P is a PacketCable and DOCSIS 1.1 certified E-MTA that provides all of the features of the TM202A with the added benefit of an integrated battery back-up system enabling the service provider to guarantee service even in the event of a power outage. This allows them to compete directly with the incumbent local exchange carrier, or ILEC. This is also available in a Euro-DOCSIS version, the Touchstone Telephony Modem 202Q.

The Touchstone Telephony Modem 402 series is our DOCSIS 2.0 and Euro-DOCSIS 2.0 family of E-MTAs. This line also is the first to incorporate Lithium-Ion battery technology. The resulting product, the Touchstone TM402P, provides extended battery back-up time. Additional versions are available offering less or no battery back-up capabilities, DOCSIS and Euro-DOCSIS variants, and country specific powering options.

The Touchstone Telephony Port 204A is a rugged, environmentally hardened outdoor E-MTA that provides high-speed data access and up to four lines of carrier-grade VoIP for service providers wishing to maintain the demarcation point on the outside of the residence. This allows them to more closely parallel the deployment model used by ILECs, which makes service and maintenance easier over the long-term.

Constant Bit Rate Products

Headend We market our headend equipment under the brand name Cornerstone Voice. Cornerstone Voice products for the headend include host digital terminals, or HDTs. An HDT is the device that provides the interfaces, controls and communications channels between public-switched networks and the HFC

network. Because the Cornerstone Voice system is easy to implement, economical and scaleable, network operators can offer telephony at low initial penetration levels and expand as customer demand increases. We design this equipment to meet the strict performance and reliability specifications, and demanding environmental requirements expected of a lifeline, carrier-class residential telephone service. This reliability and robust design enables our customers to compete with the incumbent local telephone company with an equivalent, and often superior, service offering.

Subscriber Premises The key equipment at subscriber premises is an NIU. We market our NIUs under the brand name Cornerstone Voice Port®. The Cornerstone Voice Port is the most widely deployed CBR NIU. Voice Port units operate in conjunction with the Cornerstone HDT to provide cable telephony while also maintaining a subscriber s existing video services. Operators who are also deploying high-speed data services, such as our Cornerstone, Cadant and Touchstone brands, may deploy cable modems inside the home or work premises and multiplex the data service signals onto the same HFC network as the Cornerstone Voice application. This combination of solutions provides subscribers with voice and high-speed data functionality from the same operator. The Voice Port portfolio includes a two-line single-family residence Voice Port NIU, a two-line indoor Voice Port NIU with an integrated backup battery, a four-line Voice Port NIU, and a twenty-four-line modular Voice Port NIU for multiple dwelling unit applications.

Metro and Regional Optical Transport Equipment

In March 2003, ARRIS acquired Fremont, California-based Atoga Systems. The Atoga Systems product portfolio includes the Optical Application Router, or OAR, family of hardware products and the AppDirector™ Element Management System. Together, they offer cable operators and carriers a converged multi-service transport platform to carry IP, Ethernet and time-division multiplexing, or TDM, traffic over metro synchronous optical networks, or SONET, or dense wavelength division multiplexing, or DWDM, networks at a fraction of today s costs.

The Atoga solution, when matched with the ARRIS C4 next generation CMTS, presents a complete solution for operators seeking to simplify their network designs along with offering advanced voice and data services to residential and business customers.

Operational Support Systems

Operational support systems, or OSS, are a group of networked software suites that enable operators to automate many of the functions required to install, provision, manage and grow a subscriber base while managing, maintaining and upgrading the network for the multiple services offered. Without OSS automation, operators cannot manage subscriber growth and network operations effectively.

We are partnering with leading suppliers in the industry to provide operators with the ability to automatically provision headend and subscriber premises equipment to reflect subscribers parameters, provide key data for third-party billing software, and complete maintenance operations. We are an authorized value added reseller of Alopa s MetaServ™, which provides automated provisioning software for control of the call management server, gateways, CMTS and cable modems. MetaServ works with various billing and middleware software programs. We have strategic relationships with other equipment vendors to integrate existing Cornerstone software for CMTS and cable modem OSS functions. Operators are able to perform OSS functions across Cornerstone Voice and Cornerstone Data employing the Cadant CMTS and Touchstone product lines using a common OSS solution. The Cadant G2 IMS software supports configuration performance and fault management of the Cadant C4 CMTS through easy to use graphical user interfaces. A single Cadant G2 IM Server can support up to 100 Cadant C4 CMTS chassis and 20 simultaneous client applications.

System Integration Services

We are a full service system integrator for converged services over HFC networks. We historically have been a pioneer in the voice and data over HFC business and have the experience and infrastructure in place to help operators launch these services. System integration offers the service provider a fully integrated solution

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that has been tested for end-to-end interoperability, performance, capacity, scalability, and reliability prior to ever being installed at the customer facility. We offer the operator coordination of the project management for the suppliers and the overall program, and solution assurance services for the long-term, including upgrade support, system audits, and configuration management. Our systems integration service enables operators to rapidly deploy new services on their networks with the assurance that all of the components of the network will interoperate seamlessly.

Cable Plant Infrastructure Products

We offer a variety of products that are used by MSOs to build and maintain their cable plants. Our products are complemented by our extensive channel-to-market infrastructure, which is focused on providing efficient delivery of products from stocking or drop-ship locations.

We believe that a core strength of our products is our broad selection of trusted name-brand products and strategic proprietary lines and our experience in distribution. Our name-brand products are manufactured to our specifications by manufacturing partners. These products include: taps, line passives, house passives and premises installation equipment marketed under our Regal brand name; MONARCH™ aerial and underground plant construction products and enclosures; Digicon premium F-connectors; and FiberTel fiber optic connectivity devices and accessories. Through our product selection, we are able to address substantially all broadband infrastructure applications, including fiber optics, outside plant construction, drop and premises installation, and signal acquisition and distribution.

We also resell products from hundreds of strategic supplier-partners, which include widely recognized brands to small specialty manufacturers. Through our strategic supplier-partners, we also supply ancillary products like tools and safety equipment, testing devices and specialty electronics.

Our inventory management and logistics capabilities, which are critical to our efficient and successful operation, are often leveraged to offer value-added services to our customers. These services range from just-in-time delivery, product kitting, specialized electronic interfaces, and customized reporting, to more complex and comprehensive supply chain management solutions. These services complement our products offerings with advanced channel-to-market and logistics capabilities, extensive product bundling opportunities, and an ability to deliver carrier-grade infrastructure solutions in the passive transmission portions of the network. The depth and breadth of our inventory and service capabilities enable us to provide our customers with single supplier flexibility.

Sales and Marketing

We are positioned to service customers worldwide with a sales force and supporting sales engineering resources in both domestic and international markets. The sales organization itself is divided in such a way as to allocate resources to the top MSOs worldwide while others are committed to addressing the general supplies requirements that are common across all customers. We maintain sales offices in Duluth, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; San Jose, California; Ireland; Chile; Japan; Spain; and the Netherlands. Additionally, we have partnership agreements in a variety of countries and regions with value-added resellers, or VARs, which extend our sales presence in markets without established sales offices.

Additionally, we maintain an inside sales group that is responsible for regular phone contact, prompt order entry, timely and accurate delivery and effective sales administration for the many changes frequently required in any substantial rebuild or upgrade activity. In addition, the sales structure includes sales engineers and technicians that can assist customers in system design and specification and can promptly be on site to trouble shoot any problems as they arise during a project.

We also have marketing and product management teams that focus on each of the various product categories and work with our engineers and various technology partners on new products and product improvements. These teams are responsible for inventory levels and pricing, delivery requirements, market demand and product positioning and advertising.

We are committed to providing superior levels of customer service by incorporating innovative customer-centric strategies and processes supported by business systems designed to deliver differentiating product support and value-added services. We have implemented advanced customer relationship management programs to bring additional value to our customers and provide significant value to our operations management. Through these information systems, we can provide our customers with product information ranging from operational manuals to the latest in order processing information. Through on-going development and refinement, these programs will help to improve our productivity and enable us to further improve our customer-focused services.

Customers

The majority of our sales are to cable system operators or MSOs. We also sell products to traditional telephone companies, local exchange carriers, and competitive local exchange carriers. Our broadband products can be deployed not only by cable system operators, but also by traditional telephone companies, electric utilities and others. In 2003, as the US cable industry continued a trend toward consolidation, the six largest MSOs controlled over 90% of the US cable market, thereby making our sales to those MSOs critical to our success. Internationally, the market is dominated by approximately ten cable system operators, comprised of US-based MSOs, government entities, and foreign-based multi-media owners. This group controls approximately 60% of the total international addressable market.

Our sales are substantially dependent upon a system operator s selection of our equipment, demand for increased broadband services by subscribers, and general capital expenditure levels by system operators.

Our two largest customers are Comcast (including AT&T Broadband, which was acquired by Comcast during 2002) and Cox Communications. Sales to these two customers for 2003, 2002, and 2001 are set forth below:

	Years Ended December 31,		
	2003	**2002**	**2001**
		(in millions)	
Comcast (including AT&T Broadband)	$136.6	$250.2	$245.6
% of sales	31.5%	38.4%	39.1%
Cox Communications	$104.3	$106.7	$110.9
% of sales	24.0%	16.4%	17.7%

Jupiter Telecom accounted for approximately 7.9% and 7.6% of total sales in 2003 and 2002, respectively. In 2002, Cabovisao accounted for approximately 6% of total sales for the year. In 2001, Insight and Adelphia accounted for approximately 5.0% and 8.6%, respectively, of total sales for the year. No other customers provided more than 5% of total sales for the years ended December 31, 2003, 2002, or 2001.

Although with some of our customers we do have general purchase agreements, the vast majority of our sales, to both those that have agreements and to our remaining customers, result from purchase orders or other short-term commitments. A summary of the key terms of the general purchase agreements with Comcast and Cox Communications is as follows:

Comcast. We have non-exclusive agreements with Comcast to supply C4 CMTS units and parts and to sell cable television supplies for two-year terms expiring in March 2005. Commercial terms include a requirement to supply product based on Comcast forecasts (updated quarterly), most favorable pricing as compared to similarly-situated companies, and specific delivery lead times with penalties for late delivery and warranty terms ranging from one to five years depending on the product. Included in one of these purchase agreements is a service level agreement structured to provide Comcast service assurance by providing credits for any delinquent response to service needs with special escalation guidelines for the C4 CMTS. To date, no penalties have been incurred. Comcast is not obligated to make any purchases.

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Cox Communications. We have an exclusive agreement with Cox Communications to supply Cornerstone Voice and Touchstone Telephony products and services at favorable pricing based on volume commitments. The agreement has a five-year term ending on July 31, 2007. Commercial terms include payment and delivery terms, a five-year warranty, penalties for delivery shortfall and delinquent performance guarantees. To date, no penalties have been incurred. Cox is not obligated to make any minimum purchase commitments.

Adelphia and Cabovisao, historically two of our larger customers, have uncertainties surrounding our future transactions with them, and the level of our transactions. Sales to these two customers for 2003, 2002 and 2001 are set forth below:

	Years Ended December 31,		
	2003	2002	2001
		(in millions)	
Adelphia Communications	$14.1	$25.9	$54.1
% of sales	3.2%	4.0%	8.6%
Cabovisao	$ 0.7	$39.1	$16.2
% of sales	0.2%	6.0%	2.6%

Sales to Adelphia decreased during the second quarter of 2002 as a result of Adelphia s financial troubles, which ultimately resulted in a bankruptcy filing in June 2002. As a result, in June 2002, we established a bad debt reserve of $20.2 million in connection with our accounts receivable from Adelphia. In the third quarter of 2002, we sold a portion of our Adelphia accounts receivable to an unrelated third party, resulting in a net gain of approximately $4.3 million. Sales in 2003 to Adelphia have decreased from 2002 as a result of their bankruptcy. The company has taken initial steps to restructure itself through its bankruptcy proceedings, including obtaining debtor in possession financing. We have extended commercially reasonable credit terms to Adelphia in 2003 and they have consistently paid us within those terms. At the end of 2003, Adelphia owed us approximately $0.6 million. We are uncertain whether Adelphia will be successful with its financial restructuring and what impact, if any, this may have on our future relationship with them.

Cabovisao, a Portugal-based MSO, accounted for approximately 6% of our total sales in 2002. As of November 18, 2003, Cabovisao owed us approximately $20.6 million in accounts receivable, all of which was past due. 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. In 2003 and 2002, we reserved $8.7 million and $3.6 million, respectively, for our Cabovisao receivable. On November 18, 2003 we sold our accounts receivable due from Cabovisao to an unrelated party for $10.1 million, and as a result, recorded a gain with respect to our reserves for doubtful accounts of $1.5 million in the fourth quarter of 2003. CSii is continuing its restructuring efforts. We have and will continue to sell product to Cabovisao on cash with order terms. We are uncertain what effect these developments will have on our future relationship with them.

Research and Development

We are committed to the development of new technology and rapid innovation in the evolving broadband market. New products are developed in our research and development laboratories in Suwanee, Georgia, Cork, Ireland, San Jose, California and Lisle, Illinois. We form strategic alliances with world-class producers and suppliers of complementary technology to provide best-in-class solutions focused on time-to-revenue.

Research and development expenses in 2003, 2002, and 2001 were approximately $62.9 million, $72.5 million, and $29.8 million respectively. These costs include allocated common costs associated with information technologies and facilities. The increase in 2002 was directly attributable to the inclusion of the research and development activities of Arris Interactive L.L.C. beginning with our acquisition of Arris Interactive L.L.C. on August 3, 2001, and the development of new technology following our acquisition of Cadant, Inc. on January 8, 2002. The decrease in 2003 is attributable to the closure of our development center in Andover, Massachusetts and other cost containment actions described elsewhere.

We believe that our future success depends on rapid adoption and implementation of broadband local access industry specifications, as well as rapid innovation and introduction of technologies that provide service and performance differentiation. To that end, the Cadant C4 CMTS product line continues to lead the industry in areas such as fault tolerance, wire-speed throughput and routing, and density. The Cadant C3 is designed for small to mid-size operators who are looking for a CMTS that delivers superior RF performance while only occupying one rack unit of space for delivering high-speed data services. The Touchstone™ product line offers a wide-range of DOCSIS, Euro-DOCSIS and PacketCable certified products, including Touchstone Cable Modems, Touchstone Telephony Modems and Touchstone Telephony Ports. These products are continuously being improved to include innovations that improve the subscriber s experience and help to control operations expense.

The following trends impact our current product development activities:

- Continued development and acceptance of open standards for delivering voice, video and data;
- Most US-based MSOs have announced plans to roll-out VoIP in 2004 (from limited markets to full market deployments);
- Continued increase in peer-to-peer services are accelerating demand for new services requiring intensive, high-touch processing and sophisticated management techniques;
- Innovations in video encode/decode technology are making possible very low bit rate, high quality video streaming; and
- Continued silicon integration and chip fabrication technology innovations are making possible very low cost, multi-functional broadband consumer devices, integrating not only telephony but wireless and video decompression and digital rights management functionality.

As a result, our product development activities are primarily directed at the following areas:

- Rapid development and delivery of Cadant C4 and C3 CMTS features, including DOCSIS 2.0, DOCSIS Set-top Gateway (DSG) and PacketCable Multimedia support, Layer 3 routing enhancements, packet inspection and filtering features, security enhancements, and increased downstream/upstream density;
- Expanding the range of next-generation, Lithium-Ion-based, Touchstone Telephony Modem E-MTAs to include formats to meet country and MSO specific performance, powering and cost requirements; and
- Development of network and client technologies to address the emerging worldwide market opportunities in next generation video and multimedia delivery (video over IP, PacketCable multimedia, and alternative metro transport systems).

Intellectual Property

We have an aggressive program for protecting our intellectual property. The program consists of maintaining our portfolio of 69 issued patents (both US and foreign) and pursuing patent protection on new inventions (currently more than 150 patent applications and provisional patent applications are pending). In our effort to pursue new patents, we have created a process whereby employees may submit ideas of inventions for review by management. The review process evaluates each submission for novelty, detectability, and commercial value, and patent applications are filed on the inventions that meet the criteria.

Our patents and patent applications generally are in the areas of telecommunications hardware and software, and related technologies. Our recent research and development has led to a number of patent applications in technology related to DOCSIS. Our January 2002 purchase of the assets of Cadant resulted in the acquisition of 19 US patent applications, 7 Patent Convention Treaty (PCT) applications, 5 trademark applications, 1 U.S. registered trademark and 5 registered copyrights. The Cadant patents are in the area of cable modem termination systems. Our March 2003 purchase of the assets of Atoga Systems resulted in the acquisition of 5 U.S. patent applications, which also have been filed as PCT applications. Our Atoga patents

are in the area of network traffic flow. In August of 2003, we acquired various assets of Com21, Inc. Included in those assets were 16 issued U.S. patents plus 18 U.S. patent applications. The Com21 patents cover a wide range of technologies, including wide area networks, fiber and cable systems, ATM networks and cable modem termination systems.

For technology that is not owned by us, we have a program for obtaining appropriate licenses with the industry leaders to ensure that the strongest possible patents support the licensed technology. In addition, we have formed strategic relationships with leading technology companies that will provide us with early access to technology and will help keep us at the forefront of our industry. The key technology not owned by us includes:

Components for Our CMTS Product Line

Broadcom provides several DOCSIS components in our cable modem termination system, or CMTS, product line. This DOCSIS technology is licensed under the terms of an early access program agreement. The early access program agreement provides access to this technology for one year from product release and also provides most favored nation pricing for similar volumes and terms. Several of our competitors have similar agreements with Broadcom for these components.

Components for Our Customer Premise Equipment Products

Texas Instruments provides components used in some of our customer premise equipment, or CPE, products (that is, embedded VoIP media terminal adapters, E-MTA, cable modems). Our agreements with Texas Instruments include technology licensing and component purchases. Several of our competitors have similar agreements with Texas Instruments for these components.

In addition, we purchase software for operating network and security systems or sub-systems, and a variety of routing protocols from different suppliers under standard commercial terms, including source code buy-out arrangements.

Although alternate supply and technology arrangements similar to the above are available or could be arranged, an interruption with any of the above companies could have a material impact on our business.

We have a program for protecting and developing trademarks. The program consists of procedures for the use of current trademarks and for the development of new trademarks. This program is designed to ensure that our employees properly use those trademarks and any new trademarks that will develop strong brand loyalty and name recognition. This is intended to protect our trademarks from dilution or cancellation.

Product Sourcing and Distribution

Our product sourcing strategy centers on the use of contract manufacturers to subcontract production. Our largest contract manufacturers are Solectron, Mitsumi, and AG Communications located in the United States, Japan, and the United States, respectively. The facilities owned and operated by these contract manufacturers for the production of our products are located in the United States, Mexico and the Philippines. Below is a summary of the key elements of our agreements with each of these companies:

Solectron. We provide Solectron with a 12-month rolling, non-binding forecast. We typically have a minimum of 60 days of purchase orders placed with Solectron for product. Purchase orders for delivery within 60 days are not cancelable. Purchase orders with delivery past 60 days may be cancelled with penalties of 75% for deliveries between 60 and 90 days, and 50% for deliveries between 90 and 120 days. Purchase orders with deliveries past 120 days may be cancelled without penalty. No minimum volume requirements exist. Solectron provides us with an 18-month warranty. ARRIS and Solectron entered into a supply agreement in 1998. The agreement automatically renews annually. The agreement may be terminated by either party with 120 days notice.

Mitsumi. We provide Mitsumi with a 12-month rolling, non-binding forecast. We typically have a minimum of 60 days worth of purchase orders placed with Mitsumi for product. Purchase orders for delivery within 60 days are not cancelable. Purchase orders with delivery past 60 days and up to 120 days may be

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cancelled with ARRIS reimbursing Mitsumi for reasonable out of pocket costs. Purchase orders with deliveries past 120 days may be cancelled without penalty. Mitsumi provides us with an 18-month warranty. ARRIS and Mitsumi entered into a supply agreement in 1997. The agreement automatically renews annually. The agreement may be terminated by either party with nine months notice.

AG Communications. We provide AG Communications with a 6-month rolling, non-binding forecast. We typically have a minimum of 60 days worth of purchase orders placed with AG Communications for product. Purchase orders for delivery within 60 days are not cancelable. No minimum volume requirements exist. AG Communications provides us with an 18-month warranty. We have not yet entered into a formal supply agreement with AG Communications.

We distribute a substantial number of products that are not designed or trademarked by us in order to provide our customers with a comprehensive product offering. For instance, we distribute hardware and installation products. These products are distributed through regional warehouses in North Carolina, California and Rotterdam, Netherlands and through drop shipments from our contract manufacturers located throughout the world.

Prior to 2002, we manufactured or assembled a substantial portion of our products related to our Actives, Keptel and Power product lines. Manufacturing operations ranged from electro-mechanical, labor-intensive assembly to sophisticated electronic surface mount automated assembly lines. We operated five major manufacturing facilities related to these product lines. During the third quarter of 2001, we made the decision to outsource most of our manufacturing and have since closed four facilities located in El Paso, Texas and Juarez, Mexico. The remaining factory in Rock Falls, Illinois, was closed in conjunction with the sale of the Keptel product line in April 2002.

Backlog

Our backlog consists of unfilled customer orders believed to be firm and long-term contracts that have not been completed. With respect to long-term contracts, we include in our backlog only amounts representing orders currently released for production or, in specific instances, the amount we expect to be released in the succeeding 12 months. The amount contained in backlog for any contract or order may not be the total amount of the contract or order. The amount of our backlog at any given time does not reflect expected revenues for any fiscal period. Our backlog at December 31, 2003 was approximately $53.0 million, at December 31, 2002 was approximately $43.8 million and at December 31, 2001 was approximately $119.2 million.

We believe that substantially all of the backlog existing at December 31, 2003 will be shipped in 2004.

International Opportunities

We sell our products primarily in North America. Our international revenue is generated from Asia Pacific, Europe, Latin America and Canada. The Asia Pacific market primarily includes China, Hong Kong, Japan, Korea, Singapore, and Taiwan. The European market primarily includes Austria, Belgium, France, Germany, Netherlands, Poland, Portugal, Spain, and Switzerland. The Latin American market primarily includes Argentina, the Bahamas, Chile, Colombia, Mexico, and Puerto Rico. Sales to international customers

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were approximately 18.9%, 22.7% and 11.4% of total sales for 2003, 2002 and 2001, respectively. International sales for 2003, 2002 and 2001 were as follows:

	Years Ended December 31		
	2003	2002	2001
		(in thousands)	
Asia Pacific	$36,781	$ 51,382	$20,484
Europe	27,186	67,856	31,613
Latin America	8,052	20,400	14,125
Canada	10,091	8,522	5,679
Total	$82,110	$148,160	$71,901

We believe that international opportunities exist and continue to strategically invest in worldwide marketing efforts, which have yielded some promising results in several regions. During 2001, our international group was actively engaged in replacing the Nortel Networks sales and support infrastructure that was in place with Arris Interactive L.L.C. We have made significant operational and geographical changes in the international marketplace. We consolidated our international offices and warehouses to the Netherlands (to service northern Europe) and Spain (to service southern Europe). In 2002, we consolidated our international presence in the Far East by opening a sales and warehouse facility in Japan. We currently maintain international sales offices in Japan, Spain and the Netherlands.

Competition

All aspects of our business are highly competitive. The broadband communications industry itself is dynamic, requiring companies to react quickly and capitalize on change. We must retain skilled and experienced personnel as well as deploy substantial resources to meet the changing demands of the industry. We compete with national, regional and local manufacturers, distributors and wholesalers including some companies larger than us. Our major competitors include:

ADC Telecommunications, Inc.;

Cisco Systems, Inc.;

Motorola, Inc.;

Scientific-Atlanta, Inc.;

Tellabs, Inc.;

Terayon Communications Systems, Inc.; and

TVC Communications, Inc.

Various manufacturers who are suppliers to us sell directly, as well as through distributors, into the cable marketplace. In addition, because of the convergence of the cable, telecommunications and computer industries and rapid technological development, new competitors may enter the cable market.

Since the introduction in 1996 of our Cornerstone® Voice product line, our customers have deployed over 4 million lines, giving us approximately two-thirds of the overall CBR cable telephony market. We continue to grow this business with our established customer base and attempt to add new, usually smaller, accounts. Remaining competitors in this market are Tellabs and ADC. Both continue to service their existing installed base with upgrades and extensions.

One of the principal growth markets for ARRIS is cable modem termination systems, or CMTS, which are the headend product for data and VoIP services. The largest provider of CMTS products is Cisco, which took an early lead in the initial deployment of data-only CMTS products. Cisco is expected to defend its position via both upgrades to existing products and the introduction of new products. At present Cisco continues to be a major player in data-only CMTS markets. Cisco had not previously developed a carrier-

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grade telephony CMTS product but has recently begun to market that capability. Motorola, ADC and Terayon have been emphasizing routing and carrier-grade performance for their CMTS. Terayon, due to their proprietary silicon, were successful in bringing the first DOCSIS 2.0 CMTS to market. Each of these vendors has enjoyed some success with varying customers. During 2003, we believe ARRIS has garnered additional market share in the newer generation CMTS products that enable both data and carrier grade telephony deployments.

The customer premises business consists of cable modems and voice over IP enabled modems. In the cable modem and E-MTA business, the dynamics are very different. Cable modem sales are primarily driven by price and supply chain issues while E-MTAs are focused primarily on performance. Motorola is the market leader in cable modems. This position provides them with volume advantages in manufacturing, distribution and marketing expense. Motorola also was successful in gaining an early leader status in E-MTA sales at MSOs that were the first to deploy VoIP. However, as this market accelerates, ARRIS has been gaining share with several of these customers. We compete on product throughput and our telephony experience and integration capabilities. Terayon has had some success in the cable modem business, especially in international markets. Scientific-Atlanta also has had some success in the cable modem market. ARRIS is a relatively small competitor in the cable modem market, but has a larger share of the E-MTA market. Both Scientific-Atlanta and Terayon also have E-MTA products and compete in this market. At present the E-MTA market is small but will grow as VoIP deployments ramp-up.

In the supplies distribution business we compete with national distributors, like TVC Communications, Inc., and with several local and regional distributors. Product breadth, price, availability and service are the principal competitive advantages in the supply business.

Some of our competitors, notably Cisco, Motorola and Scientific-Atlanta, are larger companies with greater financial resources and product breadth than us. This may enable them to bundle products or market and price products more aggressively than us.

Our products are marketed with emphasis on quality and are competitively priced. Product reliability and performance, superior and responsive technical and administrative support, and breadth of product offerings are key criteria for competition. Technological innovations and speed to market are additional competitive factors.

Employees

As of January 31, 2004, we had 791 full-time employees. We believe that we have maintained an excellent relationship with our employees. Our future success depends, in part, on our ability to attract and retain key executive, marketing, engineering and sales personnel. Competition for qualified personnel in the cable industry is intense, and the loss of certain key personnel could have a material adverse effect on us. We have entered into employment contracts with our key executive officers and have confidentiality agreements with substantially all of our employees. We also have a stock option program that is intended to provide substantial incentives for our key employees to remain with us.

Background and History

ARRIS is the successor to ANTEC Corporation. From its inception until its initial public offering in 1993, ANTEC was primarily a distributor of cable television equipment and was owned and operated by Anixter, Inc. Subsequently ANTEC completed several important strategic transactions and formed joint ventures designed to expand significantly its product offerings. Most recently, ANTEC formed a new holding company, ARRIS, and acquired Nortel Networks interest in Arris Interactive L.L.C., which previously had been a joint venture between ANTEC and Nortel Networks.

A synopsis of ARRIS evolution:

1969 Anixter entered the cable industry.

1987 Anixter acquired TeleWire Supply.

1988 Anixter and AT&T developed the first analog video laser transmitter for the cable industry (Laser Link I).

1991 ANTEC was established.

1993 ANTEC s initial public offering.

1994 ANTEC completed the acquisition of the following companies, which significantly expanded its product development and manufacturing capabilities:

Electronic System Products, Inc., or ESP, an engineering consulting firm with core capabilities in digital design, RF design and application specific integrated circuit development for the broadband communications industry.

Power Guard, Inc., a manufacturer of power supplies and high security enclosures for broadband communications networks.

Keptel, Inc., a designer, manufacturer and marketer of outside plant telecommunications and transmission equipment for both residential and commercial use, primarily by telephone companies.

1995 ANTEC and Nortel Networks formed Arris Interactive L.L.C., focused on the development, manufacture and sale of products that enable the provision of a broad range of telephone and data services over HFC architectures; ANTEC initially owned 25% and Nortel Networks owned 75% of the Arris Interactive L.L.C. joint venture.

1997 ANTEC acquired TSX Corporation, which provided electronic manufacturing capabilities and expanded the Company s product lines to include amplifiers and line extenders and enhanced laser transmitters and receivers and optical node product lines.

1998 ANTEC introduced the industry s first 1550 nm narrowcast transmitter and dense wavelength division multiplexing, or DWDM, optical transmission system.

1999 ANTEC completed the combination of the Broadband Technology Division of Nortel Networks, which is known as LANcity, with Arris Interactive L.L.C., resulting in an increase in Nortel Networks interest in the joint venture to 81.25% while ANTEC s interest was reduced to 18.75%.

ANTEC introduced the industry s first 18-band block converter and combined that with the DWDM allowing 144 bands on a single fiber.

2001 ARRIS acquired all of Nortel Networks ownership interest in Arris Interactive L.L.C. in exchange for approximately 49% of the common stock of a newly formed holding company, ARRIS, and a Class B membership interest in Arris Interactive L.L.C.

ARRIS sold substantially all of its power product lines. During 2000, sales in those product lines were approximately $18.0 million, and during 2001 (through the date of the sale), sales were approximately $8.1 million. ARRIS continues as an authorized distributor and representative for these power product lines.

2002 ARRIS acquired substantially all of the assets of Cadant, Inc., a privately held designer and manufacturer of next- generation cable modem termination systems.

ARRIS sold its Keptel product line. During 2001, sales in this product line to telecommunications companies were approximately $44.8 million, and during 2002 (through the date of the sale), sales were approximately $7.5 million.

ARRIS sold its Actives product line. During 2001, sales in this product line were approximately $68.2 million, and during 2002 (through the date of the sale), sales were approximately $58.8 million.

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ARRIS closed its office in Andover, Massachusetts, which was primarily a product development and repair facility.

Nortel Networks sold 15 million shares of ARRIS through a public offering reducing their position to 22 million shares

ARRIS redeemed, for cash and stock, $91.1 million of its convertible notes due May 2003.

2003 ARRIS acquired certain assets of Atoga Systems, a Fremont, California-based developer of optical transport systems for metropolitan area networks.

ARRIS completed the redemption of its convertible notes due May 2003.

ARRIS raised $125 million through a private placement of convertible notes due 2008.

ARRIS retired, at a discount, the Class B membership interest due to Nortel Networks for $88.4 million.

ARRIS repurchased and retired 8 million shares from Nortel Networks for an aggregate purchase price of $30 million (taking into account the return of $2 million forgiven on the Class B membership interest), reducing Nortel s position to 14 million shares.

ARRIS sold ESP, its engineering services product line.

ARRIS purchased certain assets of Com21 (including the stock of its Irish subsidiary), a designer and manufacturer of next generation cable modem termination systems.

Nortel Networks sold 9 million shares of ARRIS through a public offering reducing their position to 5 million shares.

ARRIS terminated its asset-based revolving bank credit facility.

2004 ARRIS converted on March 8, 2004 $50 million of its convertible notes due 2008. In connection with the redemption, ARRIS made a make-whole interest payment that included the issuance of approximately 467 thousand common shares.

Item 2. ***Properties***

We currently conduct our operations from 12 different locations; two of which we own, while the remaining 10 are leased. These facilities consist of sales and administrative offices and warehouses totaling approximately 700,000 square feet. Our long-term leases expire at various dates through 2023. We believe that our current properties are adequate for our operations. A summary of our principal leased properties that are currently in use is as follows:

Location	Description	Area (sq. ft.)	Lease Expiration
Ontario, California	Warehouse	167,480	January 31, 2009
Duluth, Georgia	Office space	122,000	June 14, 2009
Suwanee, Georgia	Office space	97,319	February 28, 2007
Englewood, Colorado	Warehouse/Office space	32,880	March 30, 2006
Lisle, Illinois	Office space	56,008	November 1, 2013
Fremont, California	Office space	39,356	June 30, 2005
Ireland	Office space	13,575	June 30, 2023
The Netherlands	Office space	6,181	December 31, 2004
Spain	Office space	3,600	July 1, 2004
Japan	Office space	3,750	January 14, 2006

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We own the following properties:

Location	Description	Area (sq. ft.)
Cary, North Carolina	Warehouse	151,500
Chicago, Illinois	Warehouse/Office space	18,000

Item 3. ***Legal Proceedings***

Mezzalingua Litigation

ARRIS was a party to three lawsuits brought by or against John Mezzalingua Associates, Inc. d/b/a PPC, including a suit initiated by Mezzalingua in July 2003 in the Federal Court for the Western District of Wisconsin.

In the first lawsuit, John Mezzalingua Associates, Inc. d/b/a PPC v. Antec Corp. No. 3.01CV-482-J-25-HTS (M.D. Fla., Jacksonville Div., filed May 4, 2001), Mezzalingua alleged that ARRIS Digicon product infringed on a design patent owned by Mezzalingua. The suit sought an unspecified amount in damages and an injunction against the sale of the allegedly infringing connectors. Following a verdict in Mezzalingua s favor on January 22, 2002, Mezzalingua was awarded approximately $1.9 million in damages plus post-judgment interest and a permanent injunction was issued on February 11, 2002. ARRIS stopped selling the allegedly infringing product and appealed the judgment.

In the second lawsuit, Arris International, Inc. and Randall A. Holliday v. John Mezzalingua Associates, Inc. d/b/a PPC, No. 01-WM-2061 (D. Colo. filed October 17, 2001), ARRIS and Mr. Holliday alleged that Mezzalingua s EX product infringes on two utility patents issued to Mr. Holliday and licensed to ARRIS. The suit sought a permanent injunction and unspecified damages for the alleged infringement. Mezzalingua counterclaimed on various grounds, including antitrust and unfair competition.

In the third lawsuit, Mezzalingua Associates, Inc. d/b/a PPC, Inc. v. Arris International, Inc., No. 03-C-0353-C (W.D. Wis. filed July 1, 2003), Mezzalingua alleged that certain of ARRIS Digicon products infringed on a utility patent issued to Mezzalingua on May 6, 2003. The Court preliminarily enjoined ARRIS further sale of the product. ARRIS stopped selling the allegedly infringing product and instead began selling a new product. The suit sought a permanent injunction and unspecified damages for the alleged infringement.

On February 8, 2004, all of the lawsuits were settled on confidential terms, and PPC granted ARRIS a license to sell its Digicon connectors. This settlement also provides protection for our entire current Digicon product line from all PPC patents, including a recently issued patent which was not the subject of the described litigation and is broader than the patents which were the subject of the litigation.

Metal Press Litigation

ARRIS is a defendant in a case entitled Metal Press S.A. de C.V. v. ARRIS International Inc. f/k/a Antec Corporation, No. 1:01-CV-2435-CAP (N.D. Ga., Atlanta Div., filed September 13, 2001). In general, Metal Press alleges that ARRIS breached a requirements contract for certain products. The suit seeks damages in the amount of approximately $7.6 million plus punitive damages and fees. Discovery is substantially complete, and ARRIS is in the process of preparing a motion for summary judgment. ARRIS does not believe that Metal Press s claims are meritorious and intends to vigorously contest them.

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Item 4. ***Submission of Matters to a Vote of Security Holders***

During the fourth quarter of 2003, no matters were submitted to a vote of our company s security holders.

EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth the name, age as of February 29, 2004, and position with us of our executive officers.

Name	Age	Position
Robert J. Stanzione	56	Chief Executive Officer, Chairman of the Board
Lawrence A. Margolis	56	Executive Vice President, Chief Financial Officer, and Secretary
Gordon E. Halverson	61	Corporate Executive Vice President, Domestic Sales
Ronald M. Coppock	49	President, International
Bryant K. Isaacs	44	President, New Business Ventures
James D. Lakin	60	President, Broadband
Robert Puccini	42	President, TeleWire Supply
David B. Potts	46	Senior Vice President, Finance and Chief Information Officer
Leonard E. Travis	41	Vice President and Controller
Marc Geraci	51	Treasurer

Robert J. Stanzione has been Chief Executive Officer since January 1, 2000. From 1998 through 1999, Mr. Stanzione was President and Chief Operating Officer of ARRIS. Mr. Stanzione has been a director of ARRIS since 1998 and has been the Chairman of the Board of Directors since May 2003. From 1995 to 1997, he was President and Chief Executive Officer of Arris Interactive L.L.C. From 1969 to 1995, he held various positions with AT&T Corporation. Mr. Stanzione also serves as a director of CoaXmedia and Georgia CF Foundation.

Lawrence A. Margolis has been Executive Vice President, Chief Financial Officer and Secretary of ARRIS since 1992 and was Vice President, General Counsel and Secretary of Anixter, Inc., a global communications products distribution company, from 1986 to 1992 and General Counsel and Secretary of Anixter from 1984 to 1986. Prior to 1984, he was a partner at the law firm of Schiff Hardin & Waite. Mr. Margolis serves as a director of Cabletel Communications Corporation.

Gordon E. Halverson has been Corporate Executive Vice President, Domestic Sales since August 2001. From April 1997 to August 2001, Mr. Halverson was Executive Vice President and Chief Executive Officer of ARRIS TeleWire Supply. From 1990 to April 1997, he was Executive Vice President, Sales of ARRIS. During the period 1969 to 1990, he held various executive positions with predecessors of ARRIS. He received the NCTA s 1993 Vanguard Award for Associates. Mr. Halverson is a member of the NCTA, Society of Cable Television Engineers, Illinois Cable Association, Cable Television Administration and Marketing Society.

Ronald M. Coppock has been President of ARRIS International since January 1997 and was formerly Vice President International Sales and Marketing for TSX Corporation. Mr. Coppock has been in the cable television and satellite communications industry for over 20 years, having held senior management positions with Scientific-Atlanta, Pioneer Communications and Oak Communications. Mr. Coppock is an active member of the American Marketing Association, Kappa Alpha Order, Cystic Fibrosis Foundation Board, and the Auburn University Alumni Action Committee.

Bryant K. Isaacs has been President of ARRIS New Business Ventures since December 2002. Prior to the sale of the Actives product line, Mr. Isaacs was President of ARRIS Network Technologies since September 2000. Prior to joining ARRIS, he was Founder and General Manager of Lucent Technologies

Wireless Communications Networking Division in Atlanta from 1997 to 2000. From 1995 through 1997, Mr. Isaacs held the position of Vice President of Digital Network Systems for General Instrument Corporation where he was responsible for developing international business strategies and products for digital video broadcasting systems.

James D. Lakin has been President of ARRIS Broadband since the acquisition of Arris Interactive L.L.C in August 2001. From October 2000 through August 2001, he was President and Chief Operating Officer of Arris Interactive L.L.C. From November 1995 until October 2000, Mr. Lakin was Chief Marketing Officer of Arris Interactive L.L.C. Prior to 1995, he held various executive positions with Compression Labs, Inc. and its successor General Instrument Corporation.

Robert Puccini has been President of ARRIS TeleWire Supply since 1999 and prior to that served as Chief Financial Officer of TeleWire for two years. Mr. Puccini brings 20 years of experience in the cable television industry to ARRIS TeleWire Supply. He has held various accounting and controller positions within the former Anixter and ANTEC Corporations. Most recently, Mr. Puccini served as Vice President, Project Management for ARRIS AT&T account. Mr. Puccini is a CPA.

David B. Potts has been the Senior Vice President of Finance and Chief Information Officer since the acquisition of Arris Interactive L.L.C. in August 2002. Prior to joining ARRIS, he was Chief Financial Officer of Arris Interactive L.L.C from 1995 through 2001. From 1984 through 1995, Mr. Potts held various executive management positions with Nortel Networks including Vice President and Chief Financial Officer of Bell Northern Research in Ottawa and Vice President of Mergers and Acquisitions in Toronto. Prior to Nortel Networks, Mr. Potts was with Touche Ross in Toronto. Mr. Potts is a member of the Institute of Chartered Accountants in Canada.

Leonard E. Travis has been Vice President and Controller of ARRIS since March 2001. From 1998 through 2001, he was the Finance Director Europe of RELTEC Corporation and the Vice President of Finance of Marconi Services Americas, a division of RELTEC s successor, Marconi, Plc. Prior to 1998, Mr. Travis held various controller positions in finance and operations at RELTEC Corporation. Prior to RELTEC, Mr. Travis was with Material Sciences and Ernst & Whinney. Mr. Travis is a CPA and a CMA.

Marc Geraci has been Treasurer of ARRIS since January 2003 and has been with ARRIS and the former ANTEC Corporation since 1994. He began with ARRIS as Controller for the International Sales Group and in 1997 was named Chief Financial Officer of that group. Prior to joining ARRIS, he was a broker/ dealer on the Pacific Stock Exchange in San Francisco for eleven years and, prior to that, in public accounting in Chicago for four years.

BOARD COMMITTEES

Our Board of Directors has three committees: Audit, Compensation, and Nominating and Corporate Governance. The charters for all three committees are located on our worldwide website at http://www.arrisi.com. The Board believes that each of its members, with the exception of Mr. Stanzione, is independent, as defined by the SEC and Nasdaq Rules. Additionally, the Board has identified Matthew Kearney and John Petty as the Audit Committee financial experts, as defined by the SEC.

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PART II

Item 5. *Market for Registrant s Common Equity and Related Stockholder Matters*

ARRIS common stock is traded on the Nasdaq National Market System under the symbol ARRS . The following table reports the high and low trading prices per share of the Company s common stock as listed on the Nasdaq National Market System:

	High	Low
2002		
First Quarter	$10.70	$7.71
Second Quarter	9.90	3.13
Third Quarter	5.10	3.04
Fourth Quarter	4.09	1.50
2003		
First Quarter	$ 5.73	$3.23
Second Quarter	6.70	3.63
Third Quarter	6.59	4.10
Fourth Quarter	7.58	4.85

We have not paid cash dividends on our common stock since our inception. On October 3, 2002, to implement our shareholder rights plan, our board of directors declared a dividend consisting of one right for each share of our common stock outstanding at the close of business on October 25, 2002. Each right represents the right to purchase one one-thousandth of a share of our Series A Participating Preferred Stock and becomes exercisable only if a person or group acquires beneficial ownership of 15% or more of our common stock or announces a tender or exchange offer for 15% or more of our common stock or under other similar circumstances.

As of March 9, 2004, there were approximately 287 record holders of our common stock. This number excludes shareholders holding stock under nominee or street name accounts with brokers.

Item 6. *Selected Consolidated Historical Financial Data*

Discontinued Operations. In 2002, we sold our Keptel and Actives product lines. As the sale of Actives and the Keptel telecommunications product lines represented components of the Company, we have reclassified the results of these product lines to discontinued operations for all periods presented in accordance with Statement of Financial Accounting Standards, or SFAS, No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, for all periods. The balance of the product lines previously reported in transmission, optical, and outside plant product category, including Keptel products that previously were and continue to be sold by Telewire to cable companies, have been combined with our supplies category. All prior period revenues have been aggregated to conform to the new product categories. All revenues from discontinued product lines included herein reflect sales to third parties.

The selected consolidated financial data as of December 31, 2003 and 2002 and for each of the three years in the period ended December 31, 2003 set forth below are derived from the accompanying audited consolidated financial statements of ARRIS, and should be read in conjunction with such statements and related notes thereto. The selected consolidated financial data as of December 31, 2001, 2000 and 1999 and for the years ended December 31, 2000 and 1999 is derived from audited consolidated financial statements that have not been included in this filing. The historical consolidated financial information is not necessarily indicative of the results of future operations and should be read in conjunction with ARRIS historical consolidated financial statements and the related notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this document. See Note 21 of the

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Notes to the Consolidated Financial Statements for a summary of our quarterly consolidated financial information.

	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
Consolidated Operating Data:					
Net sales	$433,986	$ 651,883	$ 628,323	$749,972	$587,439
Cost of sales(1)	307,726	425,231	479,663	624,720	479,252
Gross profit	126,260	226,652	148,660	125,252	108,187
Selling, general, administrative and development expenses(2)	151,980	200,574	129,743	86,721	71,136
Impairment of goodwill(3)		70,209			
Amortization of goodwill			3,256	3,300	3,324
Amortization of intangibles	35,249	34,494	7,012		
In-process R&D write-off(4)			18,800		
Restructuring and other(5)	891	7,113	11,602		1,421
Operating income (loss)	(61,860)	(85,738)	(21,753)	35,231	32,306
Interest expense	10,443	8,383	11,068	12,184	13,529
Membership interest	2,418	10,409	4,110		
Loss (gain) on debt retirement(6)	(26,164)	7,302	1,853		
Other expense (income), net	(2,329)	(5,513)	8,120	(1,271)	(1,837)
Loss on investments(7)	1,436	14,894	767	773	275
Income (loss) from continuing operations before income taxes	(47,664)	(121,213)	(47,671)	23,545	20,339
Income tax expense (benefit)(8)		(6,800)	35,588	9,622	9,202
Net income (loss) from continuing operations	(47,664)	(114,413)	(83,259)	13,923	11,137
Discontinued Operations:					
Income (loss) from discontinued operations (including a net gain on disposals of $0.4 million and a net loss of $4.0 million for the years ended December 31, 2003 and 2002, respectively)(1)(2)(5)(9)	351	(18,794)	(92,441)	11,409	10,177
Income tax expense (benefit)			(7,969)	4,663	4,604
Income (loss) from discontinued operations	351	(18,794)	(84,472)	6,746	5,573
Net income (loss) before cumulative effect of accounting change	(47,313)	(133,207)	(167,731)	20,669	16,710
Cumulative effect of accounting change(10)		57,960			
Net income (loss)	$ (47,313)	$(191,167)	$(167,731)	$ 20,669	$ 16,710
Net income (loss) per common share:					
Basic:					
Income (loss) from continuing operations	$ (0.62)	$ (1.40)	$ (1.55)	$ 0.37	$ 0.30
		(0.23)	(1.58)	0.18	0.15

Income (loss) from discontinued operations					
Cumulative effect of accounting change		(0.71)			
Net income (loss)	$ (0.62)	$ (2.33)	$ (3.13)	$ 0.54	$ 0.46

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	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
Diluted:					
Income (loss) from continuing operations	$ (0.62)	$ (1.40)	$ (1.55)	$ 0.35	$ 0.29
Income (loss) from discontinued operations		(0.23)	(1.58)	0.17	0.14
Cumulative effect of accounting change		(0.71)			
Net income (loss)	$ (0.62)	$ (2.33)	$ (3.13)	$ 0.52	$ 0.43
Selected Balance Sheet Data:					
Total assets	$451,859	$563,412	$752,115	$731,495	$700,541
Long-term obligations	$138,052	$ 11,500	$115,000	$204,000	$183,500

(1) Cost of Sales and Discontinued Operations:

In 2003, 2002, and 2001, we recorded severance costs related to reductions in force of $0.4 million, $1.5 million, and $47 thousand, respectively, which was reflected in cost of sales.

During 2002, we wrote off the remaining $2.1 million of power inventories that had not been transferred to the buyer. This charge is reflected in cost of goods sold.

In 2001, we recorded pre-tax restructuring and impairment charges of approximately $66.2 million. Of this total charge, approximately $50.1 million is classified in discontinued operations, $8.5 million is reflected in cost of goods sold, and $7.6 million is reflected in restructuring. Of the $50.1 million classified in discontinued operations, approximately $25.1 million related to the write-down of inventories, $14.8 million related to the impairment of fixed assets, $4.5 million related to lease termination and other shutdown expenses, and $5.7 million related to severance and associated personnel costs. The remaining $16.1 million related to continuing operations, of which approximately $8.5 million related to the write-down of inventories and certain purchase order and warranty obligations and was charged to cost of goods sold, and approximately $7.6 million related to the impairment of goodwill and lease termination expenses and was reflected in restructuring. Due to unforeseen delays in exiting the facility after the shutdown, the Company increased its reserve by approximately $2.4 million (charged to discontinued operations) and $4.8 million ($4.4 million charged to discontinued operations and $0.4 million charged to continuing operations) during 2002 and 2003, respectively.

In 2001, we recorded a write-off of $4.4 million related to unrecoverable inventory amounts due from a customer in Argentina (due to the economic disturbances in that region), of which approximately $1.6 million relates to and is classified in discontinued operations, and $2.8 million is reflected in cost of goods sold.

In 1999, we recorded pre-tax charges in conjunction with the closure of our New Jersey facility and the discontinuance of certain products. The charges included an inventory write-down of approximately $10.4 million, of which $3.9 million is reflected in cost of sales and $6.5 million is classified in discontinued operations. In 2000, we recorded an additional $3.5 million pre-tax charge to cost of sales related to the 1999 reorganization as a result of additional inventory write-downs.

(2) SGA&D and Discontinued Operations:

In 2003, 2002, and 2001, we recorded severance costs related to reductions in force of $2.5 million, $3.9 million, and $1.4 million, respectively, which was reflected in selling, general, administrative and development expenses.

In 2003, we recorded a charge of approximately $2.2 million related to the write-off of customer-relations software.

In 2003 and 2002, we reserved $8.7 million and $3.6 million, respectively, for our Cabovisao receivable. Cabovisao is a Portugal-based customer who owed us approximately $20.6 million in accounts receivable at the end of the third quarter 2003, of which all was past due. Cabovisao and its parent

company, Csii, have filed for court-supervised restructuring and recapitalization in Canada and are in the process of restructuring their financing. During the fourth quarter of 2003, we sold our accounts receivable to an unrelated third party for approximately $10.1 million, resulting in a gain of approximately $1.5 million.

In 2003, we sold our engineering consulting services product line, known as ESP, to an unrelated third party. The transaction resulted in a loss of approximately $1.4 million.

In 2003, we recorded a total of approximately $3.0 million related to potential patent litigation damages. The litigation involves our connector product, which is included in our supplies product category. The litigation was ultimately settled in February 2004.

During the first half of 2002, we established a reserve of $20.2 million in connection with our Adelphia receivables of which approximately $1.3 million relates to and is classified in discontinued operations, and approximately $18.9 million is reflected in selling, general, administrative and development expenses. Adelphia filed for bankruptcy in June 2002. During the third quarter of 2002, we sold a portion of our Adelphia accounts receivables to an unrelated third party, resulting in a net gain of approximately $4.3 million. Of this total gain, approximately $0.3 million relates to and is classified in discontinued operations, and $4.0 million is reflected in selling, general and administrative and development expense.

In 2000, we recorded a pre-tax gain of $2.1 million as a result of the curtailment of our defined benefit pension plan.

(3) Impairment of Goodwill

During the fourth quarter of 2002, based upon management s analysis including an independent valuation, we recorded a goodwill impairment charge of $70.2 million with respect to our supplies product line.

(4) In-process R&D write-off

During 2001, we recorded a pre-tax write-off of in-process research and development of $18.8 million in connection with the Arris Interactive L.L.C. acquisition.

(5) Restructuring and Impairment Charges and Discontinued Operations

During 2002, a restructuring charge of approximately $7.1 million was recorded in connection with the closure of our development and repair facility in Andover, Massachusetts, related to severance, lease termination, and other costs associated with closing the facility.

During 2001, we 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.

In 2001, we recorded pre-tax restructuring and impairment charges of approximately $66.2 million. Of this total charge, approximately $50.1 million is classified in discontinued operations, $8.5 million is reflected in cost of goods sold, and $7.6 million is reflected in restructuring. Of the $50.1 million classified in discontinued operations, approximately $25.1 million related to the write-down of inventories, $14.8 million related to the impairment of fixed assets, $4.5 million related to lease termination and other shutdown expenses, and $5.7 million related to severance and associated personnel costs. The remaining $16.1 million related to continuing operations, of which approximately $8.5 million related to the write-down of inventories and certain purchase order and warranty obligations and was charged to cost of goods sold, and approximately $7.6 million related to the impairment of goodwill and lease termination expenses and was reflected in restructuring. Due to unforeseen delays in exiting the facility after the shutdown, the Company increased its reserve by approximately $2.4 million (charged to discontinued operations) and $4.8 million ($4.4 million charged to discontinued operations and $0.4 million charged to continuing operations) during 2002 and 2003, respectively.

In 1999, we recorded pre-tax charges in conjunction with the closure of our New Jersey facility, which included approximately $2.6 million related to personnel costs and approximately $3.0 million related to lease termination and other costs. Of this charge of $5.6 million, approximately $1.4 million is reflected in restructuring and $4.2 million is classified in discontinued operations.

(6) Loss (Gain) on Debt Retirement

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

During the fourth quarter 2003, we chose to cancel our credit facility, which was due to expire in August 2004. As a result, we wrote off approximately $2.3 million of unamortized finance fees related to the facility upon cancellation.

During 2002, we recorded a loss of $9.3 million associated with the 4 1/2% notes due 2003 exchanges, in accordance with SFAS No. 84, *Induced Conversions of Convertible Debt*. This loss was partially offset with a gain of approximately $2.0 million related to cash repurchases of the 4 1/2% notes due 2003 in accordance with SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*.

During 2001, we recorded pre-tax charges of $1.9 million on the extinguishment of debt in accordance with EITF 96-19, *Debtor s Accounting for a Modification or Exchange of Debt Instruments*. The amount reflected unamortized deferred finance fees related to a loan agreement, which was replaced in connection with the Arris Interactive L.L.C. acquisition. In 2003, this loss was reclassified to loss from continuing operations as a result of the gain on cash repurchases recognized in the fourth quarter of 2003 in accordance with SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*.

(7) Loss on Investments

We held certain investments in the common stock of publicly traded companies, some of which are classified as trading securities and some are classified as available for sale. In addition, we hold a number of non-marketable equity securities, which are also classified as available for sale. Changes in the market value of the trading securities and gains or losses on related sales of these securities are recognized in income. Changes in the market value of the available for sale securities are recorded in other comprehensive income. However, the available for sale securities are subject to a periodic impairment review and any other than temporary impairments are recognized through 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 Issue No. 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested.* The investment in the rabbi trust is classified as an investment on our balance sheet.

During the five-year periods of 2003, 2002, 2001, 2000, and 1999, we recognized total losses of $1.4 million, $14.9 million, $0.8 million, $0.8 million, and $0.3 million, respectively, on our investments discussed above.

(8) Income Tax Expense (Benefit)

During 2002, we recognized a $6.8 million income tax benefit 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.

During 2001, as a result of the restructuring and impairment charges during that period, a valuation allowance of approximately $38.1 million against deferred tax assets was recorded in accordance with SFAS No. 109, *Accounting for Income Taxes.*

(9) Income (Loss) from Discontinued Operations

In addition to the comments within items 1, 2, and 5 above, the following items also impacted discontinued operations:

During 2001, a one-time warranty expense relating to a specific product was recorded, resulting in a pre-tax charge of $4.7 million for the expected replacement cost of this product of which all relates to and is classified in discontinued operations. We do not anticipate any further warranty expenses to be incurred in connection with this product.

During 2002, a loss of $6.2 million was recorded in connection with the sale of the Keptel product line. Additionally, during 2003, a gain of $2.2 million was recorded in connection with the sale of the Actives product line. The net loss of $4.0 million relates to and is classified in discontinued operations.

In 2003, 2002, and 2001, we recorded severance costs related to reductions in force of $0.2 million, $1.3 million, and $4.6 million, respectively, which was reflected in discontinued operations.

(10) Cumulative Effect of an Accounting Change

During 2002, we recognized a loss of approximately $58.0 million due to the cumulative effect of an accounting change. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, and upon management s analysis of our intangibles including an independent valuation, we recorded a reduction in the value of our goodwill of approximately $58.0 million primarily related to our Keptel product line.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Critical Accounting Estimates

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

(a) Revenue Recognition

ARRIS revenue recognition policies are in compliance with Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements* and Staff Accounting Bulletin No. 104, *Revenue Recognition,* 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. Sales of services are recognized at the time of performance. 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, or

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

At December 31, 2003, we had deferred revenue of $0.7 million related to shipments made to customers whereby the customer has the right of return and related to various customer service agreements.

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. The Company recognizes software license revenue, and product revenue for certain products where software is more than an incidental component of the hardware, under Statement of Position No. 97-2, *Software Revenue Recognition* (SOP 97-2), as amended by Statement of Position No. 98-9, *Software Recognition, With Respect to Certain Transactions* (SOP 98-9), when the following criteria are met: (1) there is persuasive evidence of an agreement with the customer, (2) shipment is made and title is passed, (3) the amount due from the customer is fixed and determinable, and (4) collectibility is reasonably assured. The Company assesses whether the amount due from the customer is fixed and determinable based on the terms of the

agreement with the customer, including, but not limited to, the payment terms associated with the transaction. ARRIS assesses collection based on a number of factors, including past transaction history with the customer and credit-worthiness of the customer. If the Company determines that collection of an amount due is not reasonable assured, it defers recognition of revenue until collection becomes reasonably assured.

Certain agreements also include multiple deliverables for products and/or services. The Company recognizes revenue from these agreements based on the relative fair value of the products and services. The determination of the fair value of the elements, which is based on a variety of factors including the amount ARRIS charges other customers for the products or services, price lists or other relevant information, requires judgment by management. If an undelivered element is essential to the functionality of the delivered element or required under the terms of the contract to be delivered concurrently, the Company defers the revenue on the delivered element until that undelivered element is delivered.

ARRIS internal costs incurred in developing software are charged to expense as research and development expense until technological feasibility has been established for the product, in accordance with Statement of Financial Accounting Standards No. 86 (SFAS 86), *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.* As the time period between the establishment of technological feasibility and general release of internally developed software to its customers is generally very limited, no material development costs are incurred during this period and, therefore, no such costs have been capitalized to date.

(b) Reserve for Uncollectible Accounts

We establish a reserve for doubtful accounts based upon our historical experience in collecting accounts receivable. A majority of our accounts receivable are from a few large cable system operators, either with investment rated debt outstanding or with substantial financial resources, and have very favorable payment histories. As a result, our reserve of approximately $4.4 million as of December 31, 2003 is small relative to our level of accounts receivable. Unlike businesses with relatively small individual accounts receivables from a large number of customers, if we were to have a collectibility problem with one of our major customers, it is possible the reserve we have established will not be sufficient. We held our assumptions constant, and are not planning to alter them in the current fiscal year, unless an unforeseen factor causes us to do so.

We calculate the reserve for uncollectible accounts using a model that considers customer payment history, recent customer press releases, bankruptcy filings, if any, Dun & Bradstreet reports, and financial statement review. The Company s calculation is reviewed by management to assess whether additional research is necessary, and if complete, whether there needs to be an adjustment to the reserve for uncollectible accounts. The reserve is established through a charge to the provision and represents amounts of current and past due customer receivable balances which management estimates will not be collected. In the past several years, two of our major customers encountered significant financial difficulty due to the industry downturn and tightening financial markets. As a result, we added provisions to the reserve for uncollectible accounts for the following customers (in millions):

	For the Years Ended December 31,	
	2003	2002
Adelphia	$	$(15.9)
Cabovisao	(7.2)	(3.6)

In both cases, we adjusted the reserves for these customers based upon our understanding of the situation and negotiations with them. Ultimately, we chose to sell our accounts receivable from these companies to unrelated third parties. At the end of 2003, we believe that we do not have a major customer that is in a financially distressed position.

(c) Inventory Valuation

Inventory is reflected in our financial statements at the lower of average, approximating first-in, first-out cost or market value.

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The table below sets forth inventory balances at December 31 (in millions):

	2003	2002
Gross inventory	$ 98.9	$ 119.1
Reserves	(20.3)	(14.9)
Net inventory	$ 78.6	$ 104.2

We continuously evaluate future usage of product and where supply exceeds demand, we may establish a reserve. In reviewing inventory valuations, we also review for excess and obsolete items. This requires us to estimate future usage, which, in an industry where rapid technological changes and significant variations in capital spending by system operators are prevalent, is difficult. As a result, to the extent that we have overestimated future usage of inventory, the value of that inventory on our financial statements may be overstated. When we believe that we have overestimated, we adjust for that overstatement through an increase in cost of sales in the period identified. Inherent in our valuations are certain management judgments and estimates, including markdowns, shrinkage and future forecasts, which can significantly impact ending inventory valuation and gross margin. The methodologies utilized by the Company in its application of the above methods are consistent for all periods presented.

The Company, to assist in assessing the proper valuation of inventory, conducts annual physical inventory counts at all ARRIS locations. The Company, during the past twelve months, did not have inventory valuation issues that were not already identified in prior analyses. We have held our assumptions constant, and are not planning to alter them in the current fiscal year, unless an unforeseen factor causes us to do so.

(d) Warranty

We provide, by a current charge to cost of sales in the period in which the related revenue is recognized, an estimate of future warranty obligations. The estimate is based upon historical experience. The embedded product base, failure rates, cost to repair and warranty periods are used as a basis for calculating the estimate. We also provide, by a charge to current cost of sales, estimated expected costs associated with non-recurring product failures. In the event of a significant non-recurring product failure, the amount of the reserve may not be sufficient. For example, in 2001 we had a warranty expense related to a single product and recorded a charge of $4.7 million, now classified in discontinued operations. To the extent that other non-recurring warranty claims occur in the future, the reserves that we have established may not be sufficient, cost of sales may have been understated, and a charge against future costs of sales may be necessary. As of December 31, 2003 a reserve of $4.6 million for warranty expense was reflected on the balance sheet versus a reserve of $6.0 million as of December 31, 2002. The change in the reserve balance reflects both the addition and usage of our on-going warranty claims. It also reflects the additions, usages and adjustments to our non-recurring product issues. We review and update our estimates, with respect to the non-recurring product issues on an on-going basis. The quantity of the embedded base of product in the field has been reasonably stable. The lack of volatility of the embedded base and our continued effort to control our cost to repair leads the company to believe that the reserve will be reasonably constant in the future.

Overview

Our long-term goal is to be a leading provider of broadband access products and services. Our primary market and focus is cable providers or multiple system operators, or MSOs; however, we regularly evaluate alternative outlets for our products and services for example, the telecommunications market, including U.S. regional telephone companies, local exchange companies, competitive local exchange carriers, and governmental agencies.

Industry Conditions

Our performance is largely dependent on capital spending for constructing, rebuilding, maintaining and upgrading broadband communications systems. The cable market has evolved and changed significantly over the past two years. Key developments that have or may impact us include:

Tightening of Credit Availability

After a period of increased consolidation and 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 judicious 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 June 2002, Adelphia 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 of 2002. However, we subsequently sold a portion of the Adelphia receivables during the third quarter of 2002 to an unrelated third party, resulting in a net gain of approximately $4.3 million in that quarter. For the year ended December 31, 2002, the net result was a loss of $15.9 million related to the Adelphia situation, of which $14.9 million related to continuing operations and $1.0 million related to discontinued operations.

In addition, as of November 18, 2003, Cabovisao, a Portugal-based customer, owed us approximately $20.6 million in accounts receivable, all of which was past due. This customer accounted for approximately 6% of our sales in 2002. Cabovisao and its parent company, Csii, have been in the process of restructuring their financing. On June 30, 2003, Csii filed for court-supervised restructuring and recapitalization in Canada. In 2003 and 2002, we reserved $8.7 million and $3.6 million, respectively, for our Cabovisao receivable. On November 18, 2003 ARRIS sold its accounts receivable due from Cabovisao to an unrelated party for $10.1 million. The net result was a loss of $10.8 million related to the Cabovisao situation. CSii is continuing its restructuring efforts. We are uncertain what effect, if any, these developments will have on our future relationship with them.

Decline in Spending by the MSOs on Two-Way Plant Upgrades

A significant portion of the MSOs have, or are nearing completion of their two-way plant upgrade programs. We, as well as our competitors (in particular, Scientific-Atlanta, Motorola and TVC), have sold significant amounts of equipment to the MSOs over the past five years in support of their upgrade programs. These sales were predominately of our supplies products as well as our former Transmission, Optical and Outside Plant products. We anticipate a further decline in revenues associated with these upgrades.

Increase in Spending by MSOs on New Revenue-Generating Services

While reducing their overall capital expenditures, MSOs have increased their expenditures on equipment, which allows them to create new revenue-generating opportunities, including high-speed data, telephony and digital video. We anticipate future increases in expenditures by the MSOs on products and services, which allow them to capitalize on these opportunities.

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Cable Operator Demand of Open Standards for Equipment and Services Related to High-Speed Data, Telephony and, Potentially, Digital Video

Each of the key new revenue-generating services (high-speed data, telephony and digital video) were originally made available to the MSOs by various companies using proprietary product; however, next generation product is being developed and deployed in compliance with open standards established by the cable industry:

High-speed data was offered, most significantly by ARRIS (LANcity), Motorola and Terayon, using proprietary cable modem termination systems and cable modems. In the United States, the MSOs created CableLabs to create an open standard architecture for high-speed data. This architecture was introduced in 1999 and remains the standard. ARRIS and its competitors had to respond to the creation of this standard. ARRIS has not sold proprietary high-speed data products since 2000. Similar standards exist in Europe.

Telephony was first offered, most significantly by ARRIS, Motorola, ADC and Tellabs, using proprietary constant bit rate, or CBR, headends and network interface units. ARRIS continues to sell significant volumes of CBR equipment. The MSOs, through CableLabs, have created an open architecture for VoIP telephony. We anticipate that the majority of new telephony deployments will use this architecture. ARRIS and its competitors had to respond to the creation of this new standard.

Digital Video was first offered, most significantly by Motorola, Scientific-Atlanta and Pace, using proprietary set-top boxes. We anticipate that the MSOs will ultimately drive a similar set of open interfaces for digital video.

We expect that MSOs will continue to create and demand open interfaces in the future.

Consolidation of Our Customer Base

Consolidation of our customers has, and may in the future, affect their purchases of our products. 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 products in many of its major markets. Comcast announced that, as its initial priority after its acquisition of AT&T Broadband, it would 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 and 2003, which we expect to continue into 2004.

It is possible other customer consolidations may occur which could have an impact on future sales of our products.

Our Strategy

In response to and in anticipation of the factors above, we have implemented a long-term business strategy, which includes the following key elements:

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

Leverage our current voice and data business

Strengthen and grow our supplies infrastructure distribution channel

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

Rationalize our product portfolio

Maintain and improve a strong capital structure and expense structure

Below is a summary of some of the key actions we have taken in support of these strategies.

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Acquisitions

During the third quarter of 2001, we acquired Nortel Networks interest in our joint venture Arris Interactive L.L.C. In January 2002, we purchased substantially all the assets and assumed certain liabilities of Cadant, Inc., a manufacturer of cable modem termination systems that had developed a leading design in the industry for enabling voice over IP telephony and high-speed data. In March 2003, we purchased certain assets of Atoga Systems, a developer of optical transport systems for metropolitan area networks. In August 2003, we purchased certain cable modem termination system-related assets of Com21, including the stock of its Irish subsidiary. These acquisitions were made to better position us to provide products and services to our customers that support their growing needs in the areas of high speed data, telephony and video. Below is a more detailed description of each of these acquisitions:

Acquisition of Arris Interactive L.L.C.

Overview of the Transaction

On August 3, 2001, we completed the acquisition from Nortel of the portion of Arris Interactive L.L.C. that we did not own. Arris Interactive L.L.C. was a joint venture formed by Nortel Networks and us in 1995, and immediately prior to the acquisition we owned 18.75% and Nortel Networks owned the remainder. As part of this transaction:

- A new holding company, ARRIS, was formed;
- ANTEC, our predecessor, merged with our subsidiary and the outstanding ANTEC common stock was converted, on a share-for-share basis, into ARRIS common stock;
- Nortel Networks and our company contributed to Arris Interactive L.L.C. approximately $131.6 million in outstanding indebtedness and adjusted our ownership percentages in Arris Interactive L.L.C. to reflect these contributions;
- Nortel Networks exchanged its remaining ownership interest in Arris Interactive L.L.C. for 37 million shares of ARRIS common stock (approximately 49.2% of the total shares outstanding following the transaction) and a subordinated redeemable Class B membership interest in Arris Interactive L.L.C. with a face amount of $100 million;
- ANTEC, now our wholly-owned subsidiary, changed its name to Arris International, Inc.;
- Nortel Networks designated two new members to our board of directors;
- We issued approximately 2.1 million options and 95,000 shares of restricted stock to Arris Interactive L.L.C. employees.

In connection with this transaction, we entered into an agreement with Nortel Networks whereby we paid Nortel Networks an agency fee of approximately, on average, 10% for all sales of Arris Interactive L.L.C. legacy products made to certain domestic and international customers. This agreement for domestic agency fees expired December 31, 2001. The agreement for international agency fees was terminated on December 6, 2002.

Membership Interest

In connection with the acquisition of Arris Interactive L.L.C. in August 2001, Nortel Networks exchanged its remaining ownership interest in Arris Interactive L.L.C. for 37 million shares of our common stock and a subordinated redeemable Class B membership interest in Arris Interactive L.L.C. 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 were 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 L.L.C. 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

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forgive approximately $5.9 million of the earnings on the Class B membership interest if we redeemed it prior to March 31, 2003. As noted elsewhere, we used approximately $88.4 million of the proceeds of the March 2003 convertible note offering to redeem the Class B membership interest, including the reduction in the forgiveness of the interest.

Common Stock

Of the 37 million shares of our common stock that Nortel Networks received in 2001, it currently owns 5 million shares:

Nortel Networks sold 15 million shares 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 (which had an aggregate fair market value of $32 million based on a share closing price on the Nasdaq National Market on March 24, 2003) for an aggregate purchase price of $30.0 million (taking into account the return of $2 million forgiven on the Class B membership interest).

Nortel Networks sold 9 million shares in a registered public offering on November 28, 2003.

Acquisition of Cadant, Inc.

Consistent with our strategy, on January 8, 2002, we acquired substantially all of the assets of Cadant, Inc., a privately held designer and manufacturer of next-generation cable modem termination systems. 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. We issued 2.0 million options to purchase 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 2003 for the cable modem termination systems product. These sales targets were not achieved and no additional shares of our common stock will be issued.

Acquisition of Certain Assets of Atoga Systems

On March 21, 2003, we purchased 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 lease obligations. Further, we retained approximately 28 employees and issued a total of 500,000 shares of restricted stock to those employees.

Acquisition of Certain Assets of Com21

On August 13, 2003, the Company completed the acquisition of certain cable modem termination system-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 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.

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Alliances and Cooperations

In order to enhance our offering to MSOs, in particular, in relation to their move into VoIP, we have entered into several formal and informal alliance and cooperations with various other companies. These relationships include such things as:

Resale agreements with respect to complementary products, for example, with Alopa for their operational support systems software and with Ellacoya for their peer-to-peer flow control. Resale of these products produces a profit for the Company and enables us to better serve our customers with more integrated solutions.

Interoperability testing with a wide variety of key components for other manufacturers, including call management servers, media gateways, central office switches, and cable modems. Such testing enables us to assure our customers of our products complete compatibility with products produced by these other manufacturers.

Investment in R&D

We have made significant investments through our research and development efforts in new products and expansion of our existing products. Our primary focus has been on products and services, which will enable MSOs to generate greater revenue from offering high-speed data, telephony and digital video. In 2003 we spent approximately $62.9 million on research and development, or 14.5% of revenue. We expect to continue to spend similar levels on research and development in the future.

Product Line Rationalizations

Upon evaluation and review of our product portfolio, we concluded that two product lines, Keptel and Actives, were not core to our long-term goals; thus, we sold these product lines during 2002. Both of these product lines were components of the Company, and the results of these operations for all periods have been reclassified to discontinued operations. In 2003 we also sold Electronic System Products, an engineering services product line, also not seen as core to our goals. Below is a more detailed description of each of these dispositions:

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 majority of historic sales were to telecommunication companies in applications not core to our long-term goals. 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 includes a distribution agreement whereby we will continue to distribute certain Keptel products in the cable MSO market through Telewire, our supplies distribution channel. Prior to the sale of the Keptel product line, the related products were manufactured by Keptel and were subsequently sold either directly by Keptel s sales force to telecommunications companies or through Telewire to cable companies.

Although a few Keptel products are still distributed by Telewire, in accordance with the distribution agreement from the new owner, they are no longer manufactured by the Company and only represented approximately $6.7 million of sales for the year ended December 31, 2003. The Keptel product line, excluding sales through Telewire, had approximately $44.8 million of revenue in 2001 and approximately $7.5 million of revenue in 2002, prior to the closing of the sale. 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 $7.4 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 $8.5 million. During 2002 and 2003, the loss was reduced by $2.4 million and $0.4 million, respectively, as a result of the resolution of certain estimated costs associated with the sale. With

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these adjustments, we have has now recognized a cumulative loss of approximately $5.7 million related to the transaction.

Sale of Actives Product Line

On November 21, 2002, we sold our Actives product line, excluding receivables and payables, to Scientific-Atlanta 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. In connection with the sale, we recognized a gain of approximately $2.2 million. This product line had approximately $68.2 million of revenue in 2001 and approximately $58.8 million of revenue in 2002, prior to the closing of the sale. The majority of our historic sales of this product line were in support of the MSOs two-way upgrade programs. After assessing our potential for future demand given the decline in upgrades and our relative position in the market, we concluded the product line was not core to our long-term goals. In connection with the sale, we recognized a gain of approximately $2.2 million during the fourth quarter of 2002. We incurred approximately $9.3 million of related closure costs, including severance, vendor liabilities, professional fees, and other shutdown expenses. During 2003, we reduced our accrual for vendor liabilities by $4.4 million as a result of the resolution of certain estimated costs with the sale. With this adjustment, we have now recognized a cumulative gain of approximately $6.6 million related to the transaction.

Sale of Electronic System Products (ESP) Product Line

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 $1.3 million during the twelve-month period ended December 31, 2003 (approximately 7 months of operations) and revenue of $3.9 million during the twelve-month period ended December 31, 2002. The ESP revenue is classified in the supplies product category (formerly supplies and services). 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.

Cost Reduction Actions

During the past three years we have implemented significant cost reduction actions. These actions were taken for several reasons, all with the intent to lower the breakeven point of our business:

- in conjunction with our acquisitions and product line divestitures we were left with duplicative and/or unnecessary costs that required rationalization

- as the two-way upgrades slowed and the general spending levels in the industry decreased as a result of tighter credit, it was necessary to reduce our cost structure as we experienced lower revenues

- as a result of the Comcast purchase of AT&T Broadband we experienced a sharp decline in revenues in Q4 2002 and 2003, as a result, it was necessary to reduce our cost structure

Our actions have included: closure of factories and the outsourcing of manufacturing, closure of a development facility, general reductions in force, and curtailment of certain employee benefits and bonuses. We continue to regularly examine other actions that may be taken to reduce the cost structure of the business and improve profitability. One such opportunity is the consolidation of facilities in Duluth, Georgia. During the first quarter of 2004, we will consolidate two facilities which will give us the opportunity to house many of our core technology, marketing, and headquarter functions in a single building. This consolidation will result in an annual expense reduction of approximately $1.5 million to $2.0 million, beginning in the second quarter

2004. The consolidation will require a write-off of lease costs and leasehold improvements of approximately $6.5 million to $7.5 million in the first quarter 2004.

Debt Reduction and Refinancing Actions

We have taken steps over the past three years to restructure and reduce our debt:

Notes due 2003

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.

Notes due 2008

On March 18, 2003, we issued $125.0 million of 4 1/2% convertible subordinated notes due March 15, 2008 under Rule 144A. 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. On February 4, 2004 we gave a notice of partial redemption for $50 million of the notes on March 8, 2004.

Nortel Class B Membership Interest

We used $88.4 million of the proceeds of the notes issuance to retire the membership interest of $116.9 million,, representing a $28.5 million discount. We also used the funds to repurchase and retire 8 million shares for $30.0 million (including $2 million for the reduction in the forgiveness of the return on the membership interest described elsewhere). On the date of the repurchase, the closing fair market value of the shares was approximately $32 million (closing stock price of $4.01).

Credit Facility

On August 3, 2001 ARRIS entered into an asset-based credit facility. We last accessed the facility in the fourth quarter of 2001. On several occasions during 2001, 2002, and 2003, we modified our credit facility in order to allow us to, among other things: use existing cash reserves and proceeds of asset sales to purchase or redeem our outstanding 4 1/2% convertible subordinated notes due 2003, complete our acquisitions, complete our product line dispositions, repurchase shares from Nortel, and reduce the size of the facility. The facility was due to expire on August 3, 2004. During the fourth quarter of 2003 we examined our need for a bank facility and the cost to maintain it. We concluded that the cost benefit of renewing the facility did not warrant the expenditure of funds to do so, as we did not believe it would be likely that we would require access to funds from the facility in the foreseeable future. As a result, during the fourth quarter, we wrote-off approximately $2.3 million of unamortized finance fees related to the facility upon cancellation.

The implementation of these actions has changed our business and as a result our historical results of operations will not be as indicative of future results of operations as they otherwise might suggest.

Results of Operations

Changes in Reporting Classifications

As the sales of our Actives and Keptel telecommunications product lines represent components of the Company, we have 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 which were previously reported in the former transmission, optical and outside plant product category have been combined with our supplies product category, including Keptel products that have been and continue to be sold by Telewire to cable companies. All prior period amounts have been aggregated to conform to the new product categories.

Beginning in the second quarter of 2003, we included the revenue from DOCSIS cable modems and E-MTAs in our supplies product category; previously these sales were included in the broadband product category. We decided to change the classification as these products are original equipment manufacturer (OEM) in nature and inherently carry lower margins than those products within our broadband product category. All prior period amounts have been reclassified to conform to the current presentation.

Overview

As highlighted earlier, we have faced, and in the future will face, significant changes in our industry and business. These changes have impacted our results of operations and are expected to do so in the future. As a result, we have implemented strategies both in anticipation and in reaction to the impact of these dynamics. These strategies were outlined in the Overview to the MD&A.

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Below is a table that shows our key operating data as a percentage of sales. Following the table is a detailed description of the major factors impacting the year over year changes of the key lines of our results of operations.

Key Operating Data (as a percentage of net sales)

	Years Ended December 31,		
	2003	**2002**	**2001**
Net sales	100.0%	100.0%	100.0%
Cost of sales	70.9	65.2	76.3
Gross profit	29.1	34.8	23.7
Operating expenses:			
Selling, general, and administrative expenses	19.1	15.9	15.3
Provision for doubtful accounts	1.5	3.8	0.6
R&D expense	14.5	11.1	4.7
In process R&D write-off			3.0
Restructuring and impairment charges	0.2	1.1	1.8
Impairment of goodwill		10.8	
Amortization of goodwill			0.5
Amortization of intangibles	8.1	5.3	1.1
Operating income (loss)	(14.3)	(13.2)	(3.5)
Other (income) expense:			
Interest expense	2.4	1.3	1.8
Membership interest	0.6	1.6	0.7
Loss (gain) on debt retirement	(6.0)	1.1	0.3
Loss (gain) on investments	0.3	2.3	0.1
Loss (gain) on foreign currency	(0.5)	(0.9)	
Other expense (income), net			1.3
Income (loss) from continuing operations before income taxes	(11.0)	(18.6)	(7.6)
Income tax expense (benefit)		(1.0)	5.7
Net income (loss) from continuing operations	(11.0)	(17.6)	(13.3)
Gain (loss) from discontinued operations	0.1	(2.9)	(13.4)
Net income before cumulative effect of accounting change	(10.9)	(20.4)	(26.7)
Cumulative effect of an accounting change		8.9	
Net income (loss)	(10.9)	(29.3)	(26.7)

Comparison of Operations for the Three Years Ended December 31, 2003

Net Sales

The table below sets forth our net sales for the three years ended December 31, 2003, 2002, and 2001, for each of our product categories described in Item 1 of this Form 10-K (in millions):

	Net Sales			Increase (Decrease) Between Periods			
	For the Years Ended December 31,			2003 vs. 2002		2002 vs. 2001	
	2003	2002	2001	$	%	$	%
Product Category:							
Broadband	$289.6	$448.9	$367.2	$(159.3)	(35.5)%	$ 81.7	22.2%
Supplies	144.4	203.0	261.1	(58.6)	(28.9)%	(58.1)	(22.3)%
Total sales	$434.0	$651.9	$628.3	$(217.9)	(33.4)%	$ 23.6	3.8%

The table below sets forth our domestic and international sales for the three years ended December 31, 2003, 2002, and 2001 (in millions):

	Net Sales			Increase (Decrease) Between Periods			
	For the Years Ended December 31,			2003 vs. 2002		2002 vs. 2001	
	2003	2002	2001	$	%	$	%
Domestic	$351.9	$503.7	$556.4	$(151.8)	(30.1)%	$(52.7)	(9.5)%
International:							
Asia Pacific	36.8	51.4	20.5	(14.6)	(28.4)%	30.9	150.7%
Europe	27.2	67.9	31.6	(40.7)	(59.9)%	36.3	114.9%
Latin America	8.0	20.4	14.1	(12.4)	(60.8)%	6.3	44.7%
Canada	10.1	8.5	5.7	1.6	18.8%	2.8	49.1%
Total International	82.1	148.2	71.9	(66.1)	(44.6)%	76.3	106.1%
Total	$434.0	$651.9	$628.3	$(217.9)	(33.4)%	$ 23.6	3.8%

Broadband Net Sales 2003 vs. 2002

During 2003, sales of our broadband products declined by 35.5% as compared to 2002. The significant decrease in broadband product revenue in 2003 as compared to 2002 is the result of the following factors:

Sales to Comcast for CBR telephony products declined by approximately $163.7 million year-over-year. 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 and we expect this to continue into 2004. This decline has been partially offset by an increase in C4 sales to Comcast.

In 2003 we began to achieve market traction for our new generation CMTS products. These new products include the C4, acquired as part of our Cadant acquisition, and the C3, acquired as part of our Com21 acquisition. In 2003, we had approximately $100 million of sales of these products. We believe we exited 2003 with a significant market share for these next generation CMTS products. Comcast was our most sizable customer; however, we shipped C3 and C4 to 42 customers in 2003. We expect to continue to achieve market success with the C3 and C4; however, we believe we will face significant competition from, in particular Motorola, Cisco, Terayon, and ADC. As we anticipated, Comcast and Motorola have announced that Comcast will use Motorola s CMTS in certain networks. We anticipate that other major MSOs, including Time Warner, Cox, Adelphia, Charter, UPC, and Jupiter will increase their purchases of next generation CMTS in 2004 and beyond. We and our competitors are aggressively competing for this business. Revenue per telephony subscriber is lower in the VoIP market than in the CBR market, however we anticipate the overall market for VoIP will be significantly larger.

We continue to have robust sales of our CBR product, particularly to Cox and Jupiter. Both companies expanded their footprint of HDTs in 2003, a leading indicator of future voiceport volume. We expect the footprint to further expand in 2004. We do believe that ultimately the sales of these products will decline as Cox and Jupiter complete their initial rollout of telephony. We are uncertain about the rate and timing of this decline. We anticipate that other MSOs will use VoIP as opposed to CBR for new telephony launches and that we will be positioned to participate in these launches.

Broadband product revenue internationally declined by $69.4 million during 2003 as compared to 2002. A significant portion of this decline is attributable to the reduced purchases by Cabovisao as a result of its financing difficulties; Cabovisao accounted for approximately $39.0 million of the decrease in broadband international revenue in 2003. Further, both Jupiter in Japan and VTR in Chile slowed their purchases of our CBR telephony equipment.

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Supplies Net Sales 2003 vs. 2002

Supplies product revenues decreased by approximately 28.9% in 2003 as compared to 2002. The year-over-year decrease 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 2003 was $0.2 million, as compared to revenue of $14.4 million 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 $6.5 million of the overall decrease in supplies product revenue year-over-year.

A general slowdown in MSOs infrastructure spending as a result of the tightened credit market and the decline in spending by some customers on two-way upgrades, contributed to the remaining decrease in supplies revenue year-over-year. We believe that the rate of expenditure on upgrades will continue to decline, although we do believe that both Comcast and Adelphia have more plant to complete. Consistent with general industry data, we believe that MSO spending on maintenance will increase in 2004 and beyond as the upgraded plants age.

Included in the supplies product category is DOCSIS cable modems and E-MTAs. Sales of these products increased modestly in 2003. We anticipate growth in these products in 2004 and beyond, particularly with respect to the E-MTA as VoIP launches begin in a meaningful way across the industry by multiple MSOs. We believe we have a strong early position with our E-MTA as a result of its features and our reputation and position in the market with respect to telephony. We anticipate that competition for the E-MTA will be significant and that cost will be a very strong factor. We anticipate that the gross margin percent will be neutral to positive on the future margins of our supplies portfolio. Achieving the margins is dependent on our ability to continually reduce the cost of the product(s).

Broadband Net Sales 2002 vs. 2001

Broadband product revenues increased by approximately 22.2% in 2002 as compared to sales in 2001. The key factors accounting for the change include:

Broadband revenues for 2002 included a full year of international revenue for the Cornerstone product line whereas 2001 included only five months of international revenues due to the timing of the acquisition of Arris Interactive L.L.C. on August 3, 2001. Under the previous joint venture agreement, Nortel (not ARRIS) sold the Cornerstone products internationally. This agreement terminated upon our acquisition of Nortel s share of Arris Interactive L.L.C. on August 3, 2001.

Sales in 2002 included a full year of Cadant revenues following the acquisition in January 2002.

Offsetting the above factors was a decline in sales to Comcast, following its acquisition of AT&T Broadband during the fourth quarter of 2002. 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 products in many of its major markets. Comcast announced that as its initial priority after its acquisition of AT&T Broadband, it would 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 have experienced a significant decline in sales of our CBR telephony product to Comcast in the fourth quarter of 2002, which, as we anticipated, continued into 2003.

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Supplies Net Sales 2002 vs. 2001

Supplies product revenues decreased by approximately 22.3% in 2002, as compared to 2001. The key factors accounting for the change include:

The bankruptcy filing by Adelphia and the resulting reduced sales to them accounted for approximately 52.4% of the overall decrease in supplies product revenue year over year.

A general decline in MSOs infrastructure spending contributed to the decrease in supplies sales year-over-year.

Gross Profit

The table below sets forth our gross profit for the three years ended December 31, 2003, 2002, and 2001, for each of our product categories (in millions):

	Gross Profit $			Increase (Decrease) Between Periods			
	For the Years Ended December 31,			2003 vs. 2002		2002 vs. 2001	
	2003	2002	2001	$	%	$	%
Product Category:							
Broadband	$110.1	$190.4	$105.3	$ (80.3)	(42.2)%	$85.1	80.8%
Supplies	16.2	36.3	43.4	(20.1)	(55.4)%	(7.1)	(16.4)%
Total	$126.3	$226.7	$148.7	$(100.4)	(44.3)%	$78.0	52.5%

The table below sets forth our gross margin percentages for the three years ended December 31, 2003, 2002, and 2001, for each of our product categories:

	Gross Margin %				
	For the Years Ended December 31,			Percentage Point Increase (Decrease) Between Periods	
	2003	2002	2001	2003 vs. 2002	2002 vs. 2001
Product Category:					
Broadband	38.0%	42.4%	28.7%	(4.4)	13.7
Supplies	11.2%	17.9%	16.6%	(6.7)	1.3
Total	29.1%	34.8%	23.7%	(5.7)	11.1

Broadband Gross Profit 2003 vs. 2002

The reduction in broadband gross profit dollars and percentages in 2003 as compared to 2002 was related to the following factors:

Gross profit dollars were significantly impacted in year over year declines in revenues.

The reduced sales volume contributed to lower margin percentages, as there was a lower base to cover our fixed costs.

A shift within the broadband product mix resulted in lower margins; specifically, we sold less CBR equipment in 2003 as compared to 2002.

In 2003, we recorded $8.3 million of inventory reserves versus $4.6 million in 2002.

Negatively impacting gross profit was $0.4 million and $0.7 million of employee severance for 2003 and 2002, respectively.

We continue to aggressively pursue and implement product cost reductions. In the third and fourth quarters of 2003 we implemented product cost reductions, which helped contribute to an increase in margins. Gross margin for our broadband product improved to 43.3% in the fourth quarter 2003, due to mix and the impact of the cost reductions.

Supplies Gross Profit 2003 vs. 2002

The supplies category (excluding divested product lines) has historically been a product category with gross margins ranging from 18% to 22%. Several factors have negatively impacted margin percent in recent years, as detailed below.

The decrease in revenues year over year significantly impacted gross profit dollars.

Product mix, specifically, reduced sales of higher margin power supplies in the CBR market, increased sales of lower margin cable modems, and relatively reduced sales of other proprietary products negatively impacted margin.

Increased competition in a declining revenue environment caused price erosion, which also negatively impacted gross margins.

Negatively impacting gross profit was $0.8 million of employee severance for 2002.

Inventory reserve levels in the past three years have been high, impacted by the general downturn in the industry, the Comcast acquisition of AT&T Broadband and the changing purchase patterns incident thereto and the decision to divest the powering product line. In 2003, we recorded $6.4 million (4.4% of sales) of inventory reserves versus $10.8 million (5.3% of sales) in 2002. We anticipate a return to more normal inventory reserve levels beginning in 2004.

Broadband Gross Profit 2002 vs. 2001

Gross profit and gross margin within the broadband product category were positively impacted by the Arris Interactive L.L.C. acquisition in August 2001. Prior to the acquisition, ANTEC, the predecessor to ARRIS, was a distributor of Arris Interactive L.L.C. Cornerstone products. Beginning in August 2001, the new ARRIS earned much higher margins as the manufacturer of Cornerstone products on both domestic and international sales. The year ended December 31, 2002 included a full year of this positive impact, whereas 2001 included only five months. Negatively impacting the gross margin dollars in 2001 were charges for inventory reserves of $7.6 million as compared to $4.7 million in 2002. Also, negatively impacting gross profit was severance of $0.7 million in 2002.

Supplies Gross Profit 2002 vs. 2001

Gross profit declined year over year predominately as a result of lower sales. Impacting the change in gross margin were charges for inventory reserves of $10.8 million (5.3% of sales) and $9.0 million (3.5% of sales) for 2002 and 2001, respectively. Also impacting the change in gross margin were employee severance charges of $0.8 million for 2002.

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Operating Expenses

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

	Operating Expenses			Increase (Decrease) Between Periods			
	For the Years Ended December 31,			2003 vs. 2002		2002 vs. 2001	
	2003	2002	2001	$	%	$	%
SG&A	$ 82.7	$ 103.4	$ 95.9	$ (20.7)	(20.0)%	$ 7.5	7.8%
Provision for doubtful accounts	6.4	24.7	4.0	(18.3)	(74.1)%	20.7	517.5%
R&D	62.9	72.5	29.8	(9.6)	(13.2)%	42.7	143.3%
In-process R&D write-off			18.8			(18.8)	(100.0)%
Restructuring & impairment	0.9	7.1	11.6	(6.2)	(87.3)%	(4.5)	(38.8)%
Impairment of goodwill		70.2		(70.2)	(100.0)%	70.2	NA
Amortization of goodwill			3.3			(3.3)	(100.0)%
Amortization of intangibles	35.2	34.5	7.0	0.7	2.0%	27.5	392.9%
Total	$ 188.1	$ 312.4	$ 170.4	$ (124.3)	(39.8)%	$ 142.0	83.3%

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

2003 vs. 2002

Several factors contributed to the reduction year over year:

The elimination of Nortel Networks agency fee accounted for approximately $11.7 million of the year-over-year decrease. The agreement with Nortel Networks for international agency fees terminated in December 2002.

As we have highlighted elsewhere, we have implemented several actions to reduce both SG&A and R&D costs. These actions include reductions in force, curtailment of certain employee benefits and reductions in bonuses.

Included in the SG&A expenses for 2003 and 2002 are severance costs of $1.1 million and $2.9 million, respectively.

2002 vs. 2001

Several factors contributed to the net increase year over year:

A significant factor relates to the acquisition of Arris Interactive L.L.C. Since it was purchased in August 2001, 2001 includes only five months of expense versus twelve months in 2002.

As highlighted elsewhere, we paid Nortel agency fees in both 2002 and 2001. These fees were $11.7 million and $6.1 million for 2002 and 2001, respectively.

Included in the SG&A expenses for 2002 and 2001 are severance costs of $2.9 million and $1.3 million, respectively.

Offsetting the increase were cost containment actions including general reductions in force.

Provision for Doubtful Accounts

Our provision for doubtful accounts for 2003 and 2002 was significantly impacted by our reserves for Adelphia and Cabovisao. Excluding reserves for these customers, our provision for doubtful accounts was $(0.8) million, $5.2 million and $4.0 million for 2003, 2002 and 2001, respectively.

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Research & Development Expenses

We continue to aggressively invest in research and development. Our primary focus is on products that allow MSOs to capture new revenues, in particular, high-speed data, VoIP, and Video over IP. In addition we continue to invest in our Atoga products.

Included in our R&D expenses are costs directly associated with our development efforts (people, facilities, materials, etc.) and reasonable allocations of our Information Technology and Telecom costs. In prior footnote disclosures related to research and development expense we did not include allocations of Information Technology Telecom costs or stock compensation costs. Since we have expanded our Statement of Operations disclosure to separately show research and development, and to be consistent with practices followed by other companies, research and development expense now includes such allocations in all periods presented.

2003 vs. 2002

The decrease in R&D expense year over year encompasses several factors:

The closure in November 2002 of our Andover, Massachusetts location, which was primarily a product development and repair facility. Following the purchase of Cadant, we were able to reduce duplicative effort and close this facility.

As we have highlighted elsewhere, we have implemented several actions to reduce both R&D and SG&A costs. These actions include reductions in force, curtailment of certain employee benefits and reductions in bonuses.

Included in the R&D expenses for 2003 and 2002 are severance costs of $1.3 million and $1.0 million, respectively.

Partially offsetting these decreases was the addition of expense related to the acquisition of Atoga in March 2003 and Com21 in August 2003.

Major development efforts in 2003 included work on the following: CMTS (C4, C3), CPE (DOCSIS modems & E-MTAs), Atoga product suite, sustaining effort on CBR products, product cost reductions, new initiatives (including video over IP).

2002 vs. 2001

The significant increase in R&D expense year over year also encompasses several factors:

2001 included only five months of development costs associated with the acquisition of Arris Interactive L.L.C. as we purchased the business in August 2001, whereas 2002 included a full year of expenses.

2002 included additional R&D costs as a result of the Cadant acquisition, which we purchased in January 2002. 2001 had no costs associated with Cadant.

Included in the R&D expenses for 2002 and 2001 are severance costs of $1.0 million and $0.1 million, respectively.

Offsetting the increase were cost containment actions including general reductions in force.

Write-off of In-Process R&D

During the third quarter of the year ended December 31, 2001, we wrote off acquired in-process research and development totaling $18.8 million in connection with the Arris Interactive L.L.C. acquisition.

Restructuring and Impairment Charges

During 2003, ARRIS evaluated the restructuring accruals related to previously closed facilities. Upon final review, we recorded additional restructuring charges of $0.9 million during the year ended December 31, 2003 as a result of a change to the initial estimates used.

On October 30, 2002, we announced the closure of our office in Andover, Massachusetts. We decided to close the office in order to reduce operating costs through consolidations of our facilities. The closure affected approximately 75 employees and was completed during the second quarter of 2003. In connection with this facility closure, we 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.

In the fourth quarter of 2001, we closed a research and development facility in Raleigh, North Carolina and recorded a $4.0 million charge. 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 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 the third quarter of 2001, we recorded a charge of $5.9 million related to the impairment of goodwill due to the sale of the power product lines. Additionally, we recorded a restructuring charge of approximately $1.6 million related to lease terminations of office space.

Impairment of Goodwill

We adopted SFAS No. 142, *Goodwill and Other Intangible Assets,* on January 1, 2002. Under the new rules, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually for impairment, or more frequently if impairment indicators arise. Upon adoption of SFAS No. 142, we recorded a transitional goodwill impairment loss of approximately $58.0 million, primarily related to our Keptel product line. During the fourth quarter of 2002, our remaining goodwill was reviewed, and based upon management s analysis including an independent valuation, an impairment charge of $70.2 million was recorded with respect to our supplies product category primarily due to a decline in current purchasing by Adelphia, as well as the continuing decline in the industry in general. 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.

Amortization of Goodwill

Total goodwill amortization expense for the year ended December 31, 2001 was $3.3 million. Beginning January 1, 2002, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually for impairment, or more frequently if impairment indicators arise.

Amortization of Intangibles

Our intangibles amortization expense represents amortization of existing technology acquired as a result of the Arris Interactive L.L.C. acquisition in 2001, the Cadant, Inc. acquisition in 2002, and the Atoga and Com21 acquisitions in 2003.

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Other Expense (Income)

The table below provides detail regarding our other expense (income) (in millions):

	Other Expense (Income)			Increase (Decrease) Between Periods	
	For the Years Ended December 31,			2003 vs. 2002	2002 vs. 2001
	2003	2002	2001	$	$
Interest expense	$ 10.4	$ 8.4	$ 11.1	$ 2.0	$ (2.7)
Membership interest	2.4	10.4	4.1	(8.0)	6.3
Loss (gain) on debt retirement	(26.2)	7.3	1.9	(33.5)	5.4
Loss on investments	1.4	14.9	0.8	(13.5)	14.1
Loss (gain) on foreign currency	(2.4)	(5.7)		3.3	(5.7)
Other expense (income)	0.2	0.2	8.1		(7.9)
Total expense (income)	$ (14.2)	$ 35.5	$ 25.9	$ (49.7)	$ 9.6

Interest Expense

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 subordinated notes and capital leases.

Membership Interest Expense

In conjunction with the acquisition of Arris Interactive L.L.C. in August 2001, we issued to Nortel Networks a subordinated redeemable Class B membership interest in Arris Interactive L.L.C. 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 L.L.C. held by Nortel Networks, at a discount, and, therefore, the membership interest ceased.

Gain on Debt Retirement

The net gain on debt retirement of $26.2 million in 2003 consists of two transactions:

During the first quarter 2003, we redeemed the entire Class B membership interest in Arris Interactive L.L.C. 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 fourth quarter 2003, we chose to cancel our credit facility, which was due to expire in August 2004. As a result, we wrote off approximately $2.3 million of unamortized finance fees related to the facility upon cancellation.

The net loss on debt retirement of $7.3 million in 2002 consists of two transactions:

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.

During 2002, we redeemed $75.7 million of outstanding convertible subordinated notes. The notes were redeemed at a discount, resulting in a gain on the debt retirement of $2.0 million which was recorded in

accordance with SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*.

During 2001, we recorded pre-tax charges of $1.9 million related to the extinguishment of debt in accordance with EITF Issue No. 96-19, *Debtor s Accounting for a Modification or Exchange of Debt Instruments.* The amount reflected unamortized deferred finance fees related to a loan agreement, which was replaced in connection with the Arris Interactive L.L.C. acquisition. In 2002, this loss was reclassified to loss from continuing 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.*

Loss on Investments

We held certain investments in the common stock of publicly-traded companies, which were classified as trading securities. The remaining shares of common stock were sold during 2003 and the investment was $0 at December 31, 2003. Changes in the market value of these securities and gains or losses on related sales of these securities are recognized in income and resulted in a pre-tax gain of $0.1 million in 2003 and pre-tax losses of approximately $0.6 million and $0.8 million in 2002 and 2001, respectively.

We held certain investments in the common stock of publicly traded companies totaling approximately $1.4 million at December 31, 2003, 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. As these investments have been below their cost basis for a period greater than six months, an unrealized loss of $3.5 million was considered other than temporary and recognized through income in 2002. Additional impairment charges of $0.4 million were recorded in 2003.

In addition, we hold a number of non-marketable equity securities totaling approximately $0.9 million at December 31, 2003, which are classified as available for sale. The non-marketable equity securities are subject to a periodic impairment review, which requires significant judgment as there are no open-market valuations. During 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 2002, we recorded: 1) a $3.0 million impairment for an investment in a technology start-up, as its assets were sold to another company, 2) a $1.0 million impairment for an investment in a technology start-up company, as it was unable to raise further financing and filed for bankruptcy during the second quarter, and 3) additional impairment charges of $6.0 million were recorded in the fourth quarter of 2002 relating to other non-marketable equity securities deemed to be impaired based on various factors.

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 Issue No. 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested.* A rabbi trust is a funding vehicle used to protect deferred compensation benefits from events (other than bankruptcy). The investment in the rabbi trust is classified as an investment on our balance sheet. During 2003 and 2002, we recorded unrealized gains of $0.6 million and $0.2 million related to the rabbi trust investment. In addition, in 2002 we recognized a loss of approximately $0.8 million in connection with realized losses on the related investments.

Gain in Foreign Currency

During 2003 and 2002, we recorded foreign currency gains related to our international customers whose receivables and collections are denominated 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 occasionally entered into forward contracts based on a percentage of expected foreign currency receipts.

Income Tax Expense

As we are in a cumulative loss position for tax purposes, we did not incur income tax expense (benefit) during 2003. In 2002, we recognized a tax benefit of $6.8 million due to a change in the tax laws allowing NOL carry-backs for five years, which allowed the Company to record a tax benefit. The income tax expense in 2001 was primarily the result of the restructuring and impairment charges during that period, and a valuation allowance of approximately $38.1 million against deferred tax assets was recorded in accordance with SFAS No. 109, *Accounting for Income Taxes.* Of the net income tax expense of $27.6 million in 2001, approximately $35.6 million related to continuing operations, and a benefit of $8.0 million was related to discontinued operations.

Discontinued Operations

We have adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* with respect to our Actives and Keptel product line disposals. As a result, these two product lines have been accounted for as discontinued operations and, where noted, current and historical results have been reclassified accordingly. Revenues from the discontinued operations were $66.3 million and $113.0 million for the years ended December 31, 2002 and 2001, respectively. The income (loss) from discontinued operations, net of taxes, for the years ending December 31, 2002 and 2001 was $(18.8) million and $(84.5) million, respectively. During 2002, we recorded a net loss on disposals of $4.0 million.

During 2003, we reduced our accruals for vendor liabilities, warranty issues, and other estimated costs related to disposals by $4.8 million. This adjustment was the result of settling certain vendor liabilities for amounts less than originally anticipated and changes to our original estimated disposal costs. With this adjustment, we have now recognized a cumulative gain on disposals of approximately $0.8 million related to discontinued product line disposals. Also during 2003, we increased our accrual by $4.4 million for restructuring liabilities associated with the discontinued operations of the Company s manufacturing facilities. The net result of the above transactions in 2003 was a gain of $0.4 million in discontinued operations.

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 Statements of Operations for the year ended December 31, 2002.

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Financial Liquidity and Capital Resources

Overview

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

Liquidity & Capital Resources Data

	Year Ended December 31,		
	2003	2002	2001
	(In millions, except DSO and Turns)		
Key Working Capital Items			
Cash provided by operating activities	$ 14.7	$117.4	$111.5
Cash on hand	$ 84.9	$ 98.4	$ 5.3
Accounts Receivable, net	$ 56.3	$ 81.0	$137.1
- Days Sales Outstanding (Full Year)	58	55	73
- Days Sales Outstanding (Q4)	42	72	69
Inventory	$ 78.6	$104.2	$137.1
- Turns (Full Year)	3.4	3.5	3.5
- Turns (Q4)	3.9	2.9	2.7
Key Debt Items			
Bank Revolver Debt	$ 0.0	$ 0.0	$ 0.0
Convertible Notes due 2003	$ 0.0	$ 23.9	$115.0
Convertible Notes due 2008	$125.0	$ 0.0	$ 0.0
Nortel Class B Membership Interest	$ 0.0	$114.5	$104.1
Capital Expenditures	$ 5.9	$ 7.9	$ 9.6
Shares Owned by Nortel	5.0	22.0	37.0
% Owned by Nortel	6.6%	26.7%	49.2%

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

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

2003 Notes implement a plan to retire the notes; this was ultimately accomplished in 2002 and 2003 through a combination of cash redemptions ($99.6 million) and a share exchange offer ($15.4 million)

Nortel Class B Membership Interest in Arris Interactive L.L.C. implement a plan to retire the debt; this was ultimately accomplished in 2003 at a significant discount

Growth implement a plan to ensure we have adequate capital resources, or access thereto, to execute acquisitions

Overhang implement a plan to reduce the overhang on our stock caused by Nortel Networks holdings; at the end of 2003 Nortel s holdings were down to five million shares (or approximately 6.6% of the shares outstanding)

2008 Notes implement a plan to retire the notes; the first step was taken by means of a partial redemption ($50 million) in March 2004

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The table below lists the key actions we have taken, or may take in the future, and highlights their relationship to the goals listed above. Following the table is a description of the actions taken and an explanation as to how their potential impact can be seen in the Liquidity & Capital Resources Data above.

Action	Liquidity	2003 Notes	Nortel Debt	Growth	Overhang	2008 Notes
Enter into Asset-Based Credit Facility (2001)	x			x		
Drive Inventory Reduction Programs (ongoing)	x	x	x			
Drive Accounts Receivable Improvement Programs (2001 to present)	x	x	x			
Close Factories (2001)	x					
Divest Power (2001)	x	x	x			
Divest Keptel (2002)	x	x	x			
Divest Actives (2002)	x	x	x			
Divest ESP (2003)	x					
Exchange Offer for 2003 Notes (2002)		x				
Cost Reduction Actions (ongoing)	x					
Negotiate Discount on Nortel Debt & Repurchase (2003)			x			
Negotiate Discount on Shares Held by Nortel Networks & Repurchase (2003)					x	
Issue 2008 Notes (2003)			x			
Partially Redeem 2008 Notes (March 2004)	x					x
Fully Redeem Remaining 2008 Notes (future possibility)	x					x
Enter into a New Bank Facility (future possibility)	x			x		x
Sell Shares (future possibility)	x			x		x
New Debt Offering (future possibility)	x			x		x

Asset-Based Credit Facility & Potential New Bank Facility

In August 2001, in parallel with the acquisition of Arris Interactive L.L.C., we entered into an asset-based credit facility with customary terms and covenants. The facility was necessary to close the acquisition and to provide appropriate working capital for the business. We were borrowers under this facility until October 2001. After that time we generated sufficient funds from the other actions listed above, and from operations, to pay off the facility. We ended 2003 with a cash position of approximately $85 million. In December 2003 we chose to terminate the facility. The facility was to expire on August 3, 2004. In the fourth quarter of 2003 we reviewed the need to renew or replace the facility and concluded that the cost benefit of renewing was not sufficient. This was driven in part by our cash reserves, our perspective on future cash flows, and our belief that a commercially reasonable facility would be available to us in the future, given our asset base, if we required it.

Inventory & Accounts Receivable Programs

We have generated significant liquidity through reductions in our inventory and accounts receivable levels. From 2001 to 2003 we reduced them by approximately $59 million and $81 million, respectively. Reductions in sales volumes, divestiture of non-core product lines and overall improvement in the management of these assets has contributed to the reductions. We use turns to evaluate inventory management and days sales outstanding, or DSOs, to evaluate accounts receivable management. From the table above you will note improvements, particularly as evidenced by the fourth quarter of 2003 turns of 3.9 and DSOs of 42 days.

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

Closure of Factories

In 2001 and 2002, we closed the factories we operated in Juarez, Mexico, El Paso, Texas and Rock Falls, Illinois. These factories supported the Keptel, Power and Actives product lines. With the decline in revenues of these product lines in the beginning of 2000, these factories were inefficient. We chose to outsource the production to contract manufacturers. Ultimately, we sold these product lines. The closure of the factories improved cash flow from operations as our overall costs were reduced.

Divestiture of Product Lines

We sold our Power, Keptel, Actives, and ESP product lines over the past three years. In each case, the product line was operating at a loss when we sold it. Therefore, our cash flow from operations was improved. More significantly, the proceeds we generated from the divestures provided us with flexibility for our acquisition of assets of Cadant, Atoga, and Com21 and the retirement of the 2003 Notes. We received $31.8 million in proceeds from Actives, $30.0 million from Keptel, $11.2 million from Power and $0.0 from ESP.

2003 Notes Exchange Offer

As one step in our program to retire the 2003 Notes, through a registered exchange offer in 2002 we exchanged approximately 1.6 million of our shares for $15.4 million of the notes. The balance of the notes was redeemed for cash.

Cost Reduction Actions

We have taken significant steps to reduce the cost structure including the closure of the factories, the divestiture of product lines, general reductions in force and the curtailment of certain employee benefits. This has improved our cash from operations.

2008 Notes & Nortel Debt/ Shares

In June 2002 we entered into an option agreement with Nortel Networks pursuant to which we were entitled to retire the Class B membership interest in Arris Interactive L.L.C. held by Nortel Networks at a substantial discount and repurchase up to 16 million shares. The agreement had an expiration date of June 30, 2003. In addition, we obtained from Nortel Networks an agreement to forgive approximately $5.9 million of the return on the membership interest if we redeemed it prior to March 31, 2003. In the first quarter of 2003 we had substantially completed the retirement of the 2003 Notes, and had sufficient funds to retire the balance and maintain sufficient liquidity for our business. We investigated options to raise capital to take advantage of the agreement with Nortel Networks and in March 2003 we raised $125 million through the private placement of convertible notes. The terms were at market and are described elsewhere. We used $88.4 million of the proceeds of the notes issuance to retire the membership interest of $116.9 million,, representing a $28.5 million discount. We also used the funds to repurchase and retire 8 million shares for $30.0 million (including $2 million for the reduction in the forgiveness of the return on the membership interest described

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elsewhere). On the date of the repurchase, the closing fair market value of the shares was approximately $32 million (based on a closing stock price of $4.01).

Redemption of the 2008 Notes

In February 2004 our stock price had risen to the levels required under the indenture where we were entitled to redeem, in full or in part, the 2008 Notes. On February 4, 2004, we gave notice of a partial redemption of $50 million (with a make whole payment described elsewhere to be paid in stock). On that day our stock closed at $9.36 per share. By March 8, 2004, all redeemed note holders chose to convert their notes into stock, resulting in the issuance of 10.0 million shares of ARRIS common stock.

It is possible that we will redeem additional notes in the future.

Summary of Current Liquidity Position and Potential for Future Capital Raising

We believe our current liquidity position, where we had approximately $85 million cash on hand as of December 31, 2003, together with the prospects for continued generation of cash from operations are adequate for our short- and medium-term business needs. However, a key part of our overall long-term strategy may be implemented through additional acquisitions. Either in order to be prepared to make acquisitions generally or in connection with particular acquisitions, it is possible that we will raise capital through private, or public, share or debt offerings. We believe we have the ability to access the capital markets upon commercially reasonable terms.

Contractual Obligations

Following is a summary of our contractual obligations as of December 31, 2003:

	Payments due by period			
Contractual Obligations	**1 - 3 Years**	**3 - 5 Years**	**After 5 Years**	**Total**
		(in millions)		
Current portion of long term debt	$ 1.1	$	$	$ 1.1
Long-term debt	0.1	125.0		125.1
Operating leases	22.6	9.3	13.6	45.5
Sublease income	(1.5)			(1.5)
Purchase obligations(1)	34.7			34.7
Total contractual obligations	$57.0	$134.3	$13.6	$204.9

(1) Represents obligations under agreements with non-cancelable terms to purchases goods or services. The agreements are enforceable and legally binding, and specify specific terms, including quantities to be purchased and the timing of the purchase.

Cash Flow

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

	2003	**2002**	**2001**
Cash provided by operating activities	$ 14.7	$117.4	$111.5
Cash provided by (used in) investing	(7.2)	51.2	(19.3)
Cash provided by (used in) financing	(21.1)	(75.5)	(95.7)

Net increase (decrease) in cash	$(13.6)	$ 93.1	$ (3.5)

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Operating Activities:

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

	2003	2002	2001
Net income (loss) after non-cash adjustments	$ (4.8)	$ 48.6	$ (20.3)
(Increase)/ Decrease in accounts receivable	17.0	30.7	17.8
(Increase)/ Decrease in inventory	26.2	53.4	125.9
All other net	(23.7)	(15.3)	(11.9)
Cash provided by operating activities	$ 14.7	$117.4	$111.5

We generated significant cash flow from the reductions in inventory over the past three years. This was facilitated by the sale of non-core product lines and a strong management focus on reducing inventory levels that had been built up prior to the decline in the industry in 2000. Our fourth quarter 2003 inventory turns were 3.9.

We generated significant cash flow from reductions in accounts receivable. This was facilitated by the reduction in our overall sales volume (due in part to the sale of non-core product lines) and a strong management focus on collections. Our 2003 fourth quarter DSO was 42 days.

While we believe we may be able to further improve our working capital position, future cash flow from operating activities will be more dependent on net income after adjustment for non-cash items.

Investing Activities:

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

	2003	2002	2001
Capital expenditures	$(5.9)	$ (7.9)	$ (9.6)
Acquisitions/ Other	(3.1)	(0.9)	(9.7)
Proceeds from sale of product lines	1.8	60.0	
Cash provided by (used in) investing activities	$(7.2)	$51.2	$(19.3)

Capital Expenditures Capital expenditures are mainly for test equipment and computing equipment. We anticipate investing $8.0 million to $10.0 million in 2004.

Acquisitions/ Other This represents cash investments we have made in our various acquisitions including Com21, Atoga, Cadant and various small strategic investments.

Proceeds from Sale of Product Lines This represents the cash proceeds we received from the sale of our Actives and Keptel product lines.

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Financing Activities:

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

	2003	2002	2001
Borrowing/(payment) on revolver-net	$	$	$ (89.0)
Retirement of 2003 notes	(23.9)	(73.7)	
Payments on notes payable	(0.7)		
Payments on capital leases	(2.1)	(0.9)	
Retirement of membership interest	(88.4)		
Borrowing under 2008 notes	125.0		
Borrowing under notes payable	1.6		
Sale of common stock	1.2	1.0	1.1
(Repurchase) of common stock	(28.0)	(0.1)	
Deferred financing fees paid	(5.8)	(1.8)	(7.8)
Cash provided by (used in) financing activities	$ (21.1)	$ (75.5)	$ (95.7)

As can be seen from the above table, we have substantially refinanced our capital structure over the past three years. We have eliminated our bank debt, 2003 Notes and Class B Membership Interest. We did so using cash from operating activities, sale of non-core product lines and the issue of $125 million through our 2008 notes offering.

On March 8, 2004, the Company converted approximately $50.0 million of its 4 1/2% convertible subordinated notes due 2008 in exchange for common stock. In connection with the redemption, ARRIS made a make-whole interest payment that included the issuance of approximately 467 thousand common shares valued at approximately $4.4 million which will be reflected as a loss on debt retirement in the first quarter of 2004. Additionally, the Company will write off approximately $1.6 million of deferred finance fees related to the notes in the first quarter of 2004.

Interest Rates

As of December 31, 2003, we did not have any floating rate indebtedness. At December 31, 2003, we did not have any outstanding interest rate swap agreements.

Foreign Currency

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

We have certain international customers who are billed in their local currency. The monetary value of this business has increased since the acquisition of Arris Interactive L.L.C. and its corresponding international customer base formerly served through Nortel Networks. Beginning in the third quarter of 2002, we implemented a hedging strategy and 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 will periodically review our accounts receivable in foreign currency and purchase forward contracts when appropriate. In October 2003, we purchased a put option contract for 5.0 million euros, with an expiration date of January 28, 2004. As of December 31, 2003, the market value of the contract was $0.0 million. We recorded a loss of approximately $0.2 million during the fourth quarter 2003 related to this contract.

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Financial Instruments

In the ordinary course of business, we, from time to time, will enter into financing arrangements with customers. These financial 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 December 31, 2003, we had approximately $6.1 million outstanding under letters of credit which were cash collateralized. The cash collateral is held in the form of restricted cash.

Investments

We held certain investments in the common stock of publicly traded companies, which were classified as trading securities. The remaining shares of common stock were sold during 2003 and these investments were $0 at December 31, 2003. Changes in the market value of these securities and gains or losses on related sales of these securities are recognized in income and resulted in a pre-tax gain of $0.1 million in 2003 and pre-tax losses of approximately $0.6 million and $0.8 million in 2002 and 2001, respectively.

We held certain investments in the common stock of publicly traded companies totaling approximately $1.4 million at December 31, 2003 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. As these investments have been below their cost basis for a period greater than six months, an unrealized loss of $3.5 million was considered other than temporary and recognized through income in 2002. Additional impairment charges of $0.4 million were recorded in 2003.

In addition, we hold a number of non-marketable equity securities totaling approximately $0.9 million at December 31, 2003, which are classified as available for sale. The non-marketable equity securities are subject to a periodic impairment review, which requires significant judgment as there are no open-market valuations. During 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 2002, we recorded: 1) a $3.0 million impairment for an investment in a technology start-up, as its assets were sold to another company, 2) a $1.0 million impairment for an investment in a technology start-up company, as it was unable to raise further financing and filed for bankruptcy during the second quarter, and 3) additional impairment charges of $6.0 million were recorded in the fourth quarter of 2002 relating to other non-marketable equity securities deemed to be impaired based on various factors.

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 Issue No. 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested.* A rabbi trust is a funding vehicle used to protect deferred compensation benefits from events (other than bankruptcy). The investment in the rabbi trust is classified as an investment on our balance sheet. During 2003 and 2002, we recorded unrealized gains of $0.6 million and $0.2 million related to the rabbi trust investment. In addition, in 2002 we recognized a loss of approximately $0.8 million in connection with realized losses on the related investments.

Capital Expenditures

Capital expenditures are made at a level designed to support the strategic and operating needs of the business. ARRIS capital expenditures were $5.9 million in 2003 as compared to $7.9 million in 2002 and $9.6 million in 2001. ARRIS had no significant commitments for capital expenditures at December 31, 2003. Management expects to invest approximately $8.0 million to $10.0 million in capital expenditures for the year 2004.

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Net Operating Loss Carryforwards

As of December 31, 2003, ARRIS had net operating loss, or NOL, carryforwards for domestic and foreign income tax purposes of approximately $113.9 million and $6.9 million, respectively, expiring through 2023. We established a valuation allowance against deferred tax assets in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes* during 2001. We continually review the adequacy of the valuation allowance and recognize the benefits only as reassessment indicates that it is more likely than not that the benefits will be realized.

The availability of tax benefits of NOL carryforwards to reduce ARRIS federal and state income tax liability is subject to various limitations under the Internal Revenue Code. The availability of tax benefits of NOL carryforwards to reduce ARRIS foreign income tax liability is subject to the various tax provisions of the respective countries.

As of December 31, 2003, tax benefits arising from NOL carryforwards of approximately $2.4 million, originating prior to TSX s quasi-reorganization, will be credited directly to additional paid-in capital if and when realized.

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, continue, could be, or similar variations or the negative thereof, constitute forward-looking statements with respect to the financial condition, results of operations, and business of ARRIS, including statements that are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and management s beliefs and assumptions regarding these markets. These and any other statements in this document that are not statements about historical facts are forward-looking statements. We caution investors that forward-looking statements made by us are not guarantees of future performance and that a variety of factors could cause our actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Important factors that could cause results or events to differ from current expectations are described in the risk factors 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 several years have reduced access to funding for new and existing customers, causing delays in the timing and scale of deployments of our equipment, as well as the postponement or cancellation of certain projects by our customers. In addition, during the same period, we and other vendors received notification from several customers that they were canceling new projects or scaling back existing projects or delaying new orders to allow them to reduce inventory levels which were in excess of their current deployment requirements.

Further, several of our customers have accumulated significant levels of debt and have recently announced, or are expected to announce, financial restructurings, including bankruptcy filings. For example, Adelphia has been operating under bankruptcy since the first half of 2002 and Cabovisao s Canadian parent, Csii, has been operating under bankruptcy protection since the middle of 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, the bankruptcy filing of Adelphia in June 2002 has further heightened concerns in the financial markets about the domestic cable industry. The concern, coupled with the current uncertainty and volatile capital markets, has affected the market values of domestic cable operators and may further restrict their access to capital.

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

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

- ADC Telecommunications, Inc.;
- Cisco Systems, Inc.;
- Motorola, 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 users. We may not be able to compete successfully in the future, and competition may harm our business.

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

Our two largest customers are Comcast (primarily through the recently acquired AT&T Broadband business) and Cox Communications. For the year ended December 31, 2003, sales to Comcast (including AT&T Broadband) accounted for approximately 31.5% of our total revenues, while sales to Cox Communications accounted for approximately 24.0%. 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, Jupiter Telecom accounted for approximately 7.9% of our total sales for the year ended December 31, 2003. The loss of Comcast, Cox Communications, Jupiter Telecom, or one 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.

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

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

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

On October 3, 2002, our board of directors approved the adoption of a shareholder rights plan (commonly known as a poison pill). This plan is not intended to prevent a takeover, but is intended to protect and maximize the value of shareholders interests. This 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 the developmental products are successfully developed, 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.

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 we have manufacturing or assembly plants.

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 our products are manufactured may pass laws that impair our operations, such as laws that impose exorbitant tax obligations or nationalize these manufacturing facilities.

We face risks relating to currency fluctuations and currency exchange.

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

We are exposed to various market risk factors such as fluctuating interest rates and changes in foreign currency rates. These risk factors can impact 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 7A. ***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 year ended December 31, 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. The monetary value of this business has increased since the acquisition of Arris Interactive L.L.C. and its corresponding international customer base formerly served through Nortel Networks. Changes in the monetary exchange rates may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The euro and the yen are the predominant currencies of those customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the euro and the yen versus the dollar, a hypothetical 10% weakening of the U.S. dollar (as of December 31, 2003) would provide a gain on foreign currency of approximately $1.6 million. Conversely, a hypothetical 10% strengthening of the U.S. dollar would provide a loss on foreign currency of approximately $1.6 million. As of December 31, 2003, we had no material contracts, other than accounts receivable, denominated in foreign currencies.

We will periodically review our accounts receivable in foreign currency and purchase additional forward contracts when appropriate. In October 2003, we purchased a put option contract for 5.0 million euros, with an expiration date of January 28, 2004. As of December 31, 2003, the market value of the contract was $0.0 million. We recorded a loss of approximately $0.2 million during the fourth quarter 2003 related to this contract.

Item 8. ***Consolidated Financial Statements and Supplementary Data***

The report of independent auditors and consolidated financial statements and notes thereto for the Company are included in this Report and are listed in the Index to Consolidated Financial Statements.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

N/ A

Item 9A. ***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 the end of the period covered by this 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 Control over Financial Reporting.* Our Chief Executive Officer and Chief Financial Officer have evaluated any changes in our internal control over financial reporting that occurred during the most recent fiscal quarter. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that there has been no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

To the Board of Directors and Stockholders

ARRIS Group, Inc.

We have audited the accompanying consolidated balance sheets of ARRIS Group, Inc. as of December 31, 2003 and 2002 and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of ARRIS management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ARRIS Group, Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 3 of the Notes to the Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* and Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* in 2002, and Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* in 2003.

/s/ ERNST & YOUNG LLP

Atlanta, Georgia
February 13, 2004, except for Note 22, as to which the date is March 11, 2004

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ARRIS GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2003	2002
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 84,882	$ 98,409
Accounts receivable (net of allowances for doubtful accounts of $4,446 in 2003 and $10,698 in 2002)	56,344	78,743
Accounts receivable from Nortel Networks		2,212
Other receivables	1,280	3,154
Inventories	78,562	104,203
Investments held for resale		137
Restricted cash	6,135	
Other current assets	7,900	13,132
Total current assets	235,103	299,990
Property, plant and equipment (net of accumulated depreciation of $53,823 in 2003 and $44,810 in 2002)	25,376	34,540
Goodwill	150,569	151,265
Intangibles (net of accumulated amortization of $76,756 in 2003 and $41,506 in 2002)	30,362	64,843
Investments	5,504	6,296
Other assets	4,945	6,478
	$ 451,859	$ 563,412
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 24,293	$ 24,253
Accrued compensation, benefits and related taxes	4,267	12,081
Accounts payable and accrued expenses Nortel Networks	96	11,303
Current portion of long-term debt	1,073	23,887
Current portion of capital lease obligations	14	1,120
Other accrued liabilities	34,683	44,360
Total current liabilities	64,426	117,004
Capital lease obligations, net of current portion		158
Long-term debt, net of current portion	125,092	
Other long-term liabilities	12,960	11,342
Total liabilities	202,478	128,504
Membership interest Nortel Networks		114,518
Total liabilities & membership interest	202,478	243,022
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; 75.4 million and 82.5 million shares issued and outstanding in 2003 and 2002, respectively	773	831

Capital in excess of par value	586,008	603,563
Accumulated deficit	(328,642)	(281,329)
Unrealized holding gain on marketable securities	771	227
Unearned compensation	(8,104)	(1,649)
Unfunded pension losses	(1,293)	(1,219)
Cumulative translation adjustments	(132)	(34)
Total stockholders equity	249,381	320,390
	$ 451,859	$ 563,412

See accompanying notes to the consolidated financial statements.

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ARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2003	**2002**	**2001**
	(in thousands, except per share data)		
Net sales (includes sales to Nortel Networks of $0.5 million, $3.2 million and $23.4 million for the years ended December 31, 2003, 2002, and 2001, respectively)	$433,986	$ 651,883	$ 628,323
Cost of sales	307,726	425,231	479,663
Gross profit	126,260	226,652	148,660
Operating expenses:			
Selling, general, and administrative expenses	82,688	103,422	95,960
Provision for doubtful accounts	6,429	24,667	3,992
Research and development expenses	62,863	72,485	29,791
In-process R&D write-off			18,800
Restructuring and impairment charges	891	7,113	11,602
Impairment of goodwill		70,209	
Amortization of goodwill			3,256
Amortization of intangibles	35,249	34,494	7,012
	188,120	312,390	170,413
Operating income (loss)	(61,860)	(85,738)	(21,753)
Other expense (income):			
Interest expense	10,443	8,383	11,068
Membership interest	2,418	10,409	4,110
(Gain) loss on debt retirement	(26,164)	7,302	1,853
Loss on investments	1,436	14,894	767
(Gain) loss on foreign currency	(2,383)	(5,739)	(10)
Other expense (income), net	54	226	8,130
Income (loss) from continuing operations before income taxes	(47,664)	(121,213)	(47,671)
Income tax expense (benefit)		(6,800)	35,588
Net income (loss) from continuing operations	(47,664)	(114,413)	(83,259)
Discontinued Operations:			
Income (loss) from discontinued operations (including a net gain on disposals of $0.4 million and a net loss on disposals of $4.0 million for the years ended December 31, 2003 and 2002, respectively)	351	(18,794)	(92,441)
Income tax expense (benefit)			(7,969)
Income (loss) from discontinued operations	351	(18,794)	(84,472)
Net income (loss) before cumulative effect of an accounting change	(47,313)	(133,207)	(167,731)
Cumulative effect of an accounting change goodwill		57,960	
Net income (loss)	$ (47,313)	$(191,167)	$(167,731)

Net income (loss) per common share:			
Basic:			
Income (loss) from continuing operations	$ (0.62)	$ (1.40)	$ (1.55)
Income (loss) from discontinued operations		(0.23)	(1.58)
Cumulative effect of an accounting change		(0.71)	
Net income (loss)	$ (0.62)	$ (2.33)	$ (3.13)
Diluted:			
Income (loss) from continuing operations	$ (0.62)	$ (1.40)	$ (1.55)
Income (loss) from discontinued operations		(0.23)	(1.58)
Cumulative effect of an accounting change		(0.71)	
Net (loss) income	$ (0.62)	$ (2.33)	$ (3.13)
Weighted average common shares:			
Basic	76,839	81,934	53,624
Diluted	76,839	81,934	53,624

See accompanying notes to the consolidated financial statements.

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ARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2003	**2002**	**2001**
		(in thousands)	
Operating activities:			
Net (loss) income	$ (47,313)	$ (191,167)	$ (167,731)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation	16,145	20,400	18,089
Amortization of goodwill			4,872
Amortization of intangibles	35,249	34,494	7,012
Amortization of deferred finance fees	4,621	2,859	1,772
Amortization of unearned compensation	3,370	1,850	1,076
Loss from equity investment			8,607
Provision for doubtful accounts	7,906	29,744	5,820
Gain on sale of Adelphia receivable		(4,277)	
Gain on sale of Cabovisao receivable	(1,477)		
Loss (gain) on disposal of fixed assets	252	322	(448)
Deferred income taxes			19,273
Loss on investments	1,436	14,894	788
Cash proceeds from sale of trading securities	226	60	
Write-off of acquired in-process R&D			18,800
Impairment of goodwill		70,209	5,877
Impairment of fixed assets			14,722
Write-down of inventories			31,970
Loss (gain) on debt retirement	(26,164)	7,302	
Loss on sale of power product line			9,225
Loss on sale of ESP product line	1,365		
Loss (gain) on discontinued product lines	(351)	3,959	
Cumulative effect of an accounting change goodwill		57,960	
Changes in operating assets and liabilities, net of effect of acquisitions and dispositions:			
Adelphia accounts receivable		20,194	
Cabovisao accounts receivable	8,321		
Accounts receivable	8,671	10,505	17,771
Other receivables	1,874	6,895	(10,049)
Inventories	26,210	53,431	125,891
Income taxes recoverable		5,066	17,895
Accounts payable and accrued liabilities	(24,319)	(36,820)	(24,644)
Accrued membership interest	2,418	10,409	4,110
Other, net	(3,708)	(897)	795
Net cash provided by (used in) operating activities	14,732	117,392	111,493
Investing activities:			
Purchases of property, plant and equipment	(5,916)	(7,923)	(9,556)
Cash proceeds from sale of property & equipment			1,061
Cash proceeds from sale of Keptel product line		30,000	
Cash proceeds from sale of Actives product line	1,800	30,000	
Cash paid for acquisition, net of cash acquired	(2,842)	(874)	(6,852)
Cash paid for disposal of product line	(231)		
Other	26	(50)	(3,930)

Net cash provided by (used in) investing activities	(7,163)	51,153	(19,277)
Financing activities:			
Proceeds from issuance of debt	126,597		
Redemption of preferred membership interest	(88,430)		
Repurchase and retirement of common stock	(28,000)		
Borrowings under credit facilities			302,726
Reductions in borrowings under credit facilities			(391,726)
Payments on capital lease obligations	(2,130)	(903)	
Payments on debt obligations	(24,585)	(73,737)	
Deferred financing costs paid	(5,797)	(1,725)	(7,813)
Repurchase of stock units		(115)	
Proceeds from issuance of common stock	1,249	1,007	1,146
Net cash provided by (used in) financing activities	(21,096)	(75,473)	(95,667)
Net increase (decrease) in cash and cash equivalents	(13,527)	93,072	(3,451)
Cash and cash equivalents at beginning of year	98,409	5,337	8,788
Cash and cash equivalents at end of year	$ 84,882	$ 98,409	$ 5,337
Noncash investing and financing activities:			
Net tangible assets acquired, excluding cash	$ 2,267	$ 5,063	$ 55,284
Net liabilities assumed	(1,903)	(14,955)	
Intangible assets acquired, including goodwill	2,641	79,339	195,193
Noncash purchase price, including 5,250,000 shares of common stock in 2002 and 37,000,000 shares of common stock in 2001, and fair market value of stock options issued		(68,573)	(243,625)
Cash paid for acquisition, net of cash acquired	$ 3,005	$ 874	$ 6,852
Equity received in exchange for services provided	$	$	$ 1,000
Equity issued in exchange for 4 1/2% convertible subordinated notes due 2003	$	$ 14,497	$
Supplemental cash flow information:			
Interest paid during the year	$ 4,387	$ 5,949	$ 8,952
Income taxes paid during the year	$ 95	$ 2,831	$ 465

See accompanying notes to the consolidated financial statements.

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ARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Common Stock	Capital in Excess of Par Value	Retained Earnings (Accumulated Deficit)	Unrealized Loss on Marketable Securities	Unearned Compensation	Unfunded Pension Losses	Cumulative Translation Adjustments	Total
				(in thousands)				
Balance, January 1, 2001	$383	$266,216	$ 77,569	$(1,668)	$ (678)	$	$ 80	$ 341,902
Comprehensive income (loss):								
Net income (loss)			(167,731)					(167,731)
Unrealized loss on marketable securities				(1,543)				(1,543)
Translation adjustment							8	8
Comprehensive income (loss)								(169,266)
Shares granted under stock award plan		975			(975)			
Compensation under stock award plan					1,076			1,076
Issuance of common stock to acquire Arris Interactive L.L.C	370	226,810						227,180
Issuance of stock options in acquisition of Arris Interactive L.L.C		12,531						12,531
Issuance of common stock and other	2	1,118						1,120
Balance, December 31, 2001	755	507,650	(90,162)	(3,211)	(577)		88	414,543
Comprehensive income (loss):								
Net income (loss)			(191,167)					(191,167)
Unrealized loss on marketable securities				(86)				(86)
Recognized unrealized loss on marketable securities				3,524				3,524
Minimum liability on unfunded pension						(1,219)		(1,219)
Translation adjustment							(122)	(122)
Comprehensive (loss)								(189,070)
Shares granted under stock award plan	1	3,139			(3,140)			
Compensation under stock award plan					1,850			1,850
Repurchase of stock units		(237)			122			(115)
Forfeiture of restricted stock		(96)			96			
Issuance of common stock in acquisition of Cadant, Inc.	53	55,760						55,813
Issuance of stock options in acquisition of Cadant, Inc.		12,760						12,760
Issuance of common stock in conversion of 4 1/2% notes	16	24,042						24,058
Issuance of common stock and other	6	545						551
Balance, December 31, 2002	$831	$603,563	$(281,329)	$ 227	$(1,649)	$(1,219)	$ (34)	$ 320,390

Comprehensive income (loss):

Net income (loss)			(47,313)					(47,313)
Unrealized loss on marketable securities				544				544
Minimum liability on unfunded pension adjustment						(74)		(74)
Translation adjustment							(98)	(98)
Comprehensive income (loss)								(46,941)
Shares granted under option exchange program	14	7,623			(7,637)			
Shares granted under stock award plan	2	706			(708)			
Compensation under stock award plan					3,370			3,370
Repurchase of Nortel shares	(80)	(27,920)						(28,000)
Forfeiture of restricted stock	(1)	(674)			675			
Issuance of restricted stock Atoga employee retention	5	2,150			(2,155)			
Common stock returned Cadant settlement	(1)	(683)						(684)
Issuance of common stock and other	3	1,243						1,246
Balance, December 31, 2003	$773	$586,008	$(328,642)	$ 771	$(8,104)	$(1,293)	$(132)	$ 249,381