
ARM FISCAL Q3 2024 EARNINGS

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CONTEXT

Arm Holdings reported a solid financial fiscal 3Q 2024, exceeding expectations and highlighting its robust position in the technology sector. In its earnings call, the company announced record revenues and raised its revenue guidance for the upcoming quarter.

Arm attributed its gains to the successful adoption of its Armv9 products and significant increases in royalty and licensing revenues. Arm's expansion beyond the mobile market has also contributed to its financial success.

This Research Note explores Arm's performance during the quarter, focusing on the key factors and strategies that have driven the company's success in the technology industry.

QUARTER PERFORMANCE

During the quarter, Arm demonstrated a strong financial performance, with notable growth in revenues and profits. Key financial figures for the quarter include:

- **Total Revenue:** Arm reported revenues of \$824 million, marking a 14% increase year-over-year.
- **Royalty Revenue:** The company's royalty revenue reached \$470 million, an 11% rise compared to the same period in the previous year. This growth was primarily driven by the recovery of the semiconductor industry and the increasing adoption of Armv9-based chips, which Arm noted typically command higher royalty rates.
- **License Revenue:** License revenue was better than expected, amounting to \$354 million, an 18% increase year-over-year. This was due to strong demand for more advanced Arm CPUs as companies increased investment in AI across all end markets.
- **Non-GAAP Operating Profit:** The non-GAAP operating profit for the quarter was \$338 million, representing a 17% increase year-over-year.

- **Non-GAAP Operating Margin:** The company achieved a non-GAAP operating margin of 41.0%.

The quarter's results were driven by the successful adoption of higher-value Armv9 technology, market share gains in the cloud server and automotive sectors, and the growing influence of AI.

EARNINGS CALL HIGHLIGHTS

During the conference call, Arm CEO Rene Haas highlighted several highlights for the quarter:

- **Record Revenue Achievement:** Arm experienced an exceptional quarter, marked by record revenues exceeding its initial guidance's higher end. This strong financial performance underscores the company's robust growth and market appeal.
- **Anticipation of Continued Growth:** The company is celebrating a successful quarter and expects this trend to continue. They have projected another record quarter for Q4 and raised their financial guidance accordingly, indicating a positive outlook and sustained growth momentum.
- **Growing Datacenter/Cloud Demand:** There is a growing demand for AI-related workloads in data centers, both in terms of training and inference, serviced by offerings such as AWS Graviton, Ampere Computing, NVIDIA Grace, and Microsoft's recently announced Cobalt processor.
- **Product Transition Impacting Royalties:** A significant transition was noted from Arm's v8 product to its more advanced v9 product. The newer v9 product commands approximately double the royalty rate compared to the v8. This transition has positively impacted the company's royalty revenue, which increased from 10% to 15% of their total revenue in the quarter.
- **Strong AI and Licensing Growth:** Arm has seen considerable growth driven by AI applications. This includes high-end devices for AI training and inference and edge devices like smartphones, where AI usage is increasing. This surge in AI applications has, in turn, spurred robust growth in Arm's licensing sector.
- **Diverse Market Impact:** The growth in royalties was not confined to just one sector but spanned across multiple markets, including smartphones, infrastructure, and others. This diversification of market impact illustrates Arm's broad applicability and relevance across various technology sectors.
- **Demand for Advanced Technologies:** There's a growing market demand for Arm's advanced technologies, particularly in the context of AI. This demand is driving the need for more Arm technology in new designs, mainly to keep up with the increasing requirements of AI applications.

Arm's strong quarter was marked by record revenues, successful product transitions, significant growth in AI and licensing sectors, and an optimistic outlook for continued growth. This performance reflects the company's strong market position and the increasing demand for its advanced technology solutions in various sectors.

OUTLOOK

Arm offered guidance and outlook that reflects an optimistic view of the company's future performance:

- **Raised Revenue Guidance for Q4:** Arm has increased its revenue guidance for the fourth quarter to \$850 million to \$900 million, with a midpoint of \$875 million. This revised guidance represents a significant uplift of over \$95 million compared to their previous forecast for the fourth quarter, indicating strong business momentum.
- **Full-Year Revenue Projection:** Arm adjusted its full-year revenue guidance to between \$3.155 billion and \$3.205 billion, representing an increase of \$160 million at the midpoint versus their prior guidance.
- **Royalty Revenue Growth:** For the Q4 period, Arm expects royalty revenues to grow sequentially in the mid-single digits and up by over 30% year-over-year. Arm expected that the increasing penetration of Armv9 products, which have higher royalty rates compared to Armv8 products, will be a significant contributor to its growth.
- **Diversified Revenue Sources:** While around 35% of Arm's royalty revenue comes from smartphones, the company benefits from diversification, with 65% of its royalty revenue arising from markets beyond mobile. This diversification is expected to contribute to revenue growth, with gains in market share and share gains outside the mobile sector.
- **Strong Licensing Performance:** Arm anticipates another robust quarter for licensing, expecting revenue to be up sequentially and reach near-record levels, driven by continued high demand for their latest technologies, including AI-capable CPUs and Compute Subsystems.
- **Operational Expense Forecast:** Arm projects Non-GAAP operational expenses for Q4 to be approximately \$490 million, contributing to a full-year expectation of around \$1.7 billion. This operational expense guidance includes a slight increase due to higher R&D spending.
- **Earnings Per Share (EPS) Expectations:** The company forecasts Q4 non-GAAP fully diluted EPS to be between \$0.28 and \$0.32, with the full-year non-GAAP fully diluted EPS expected to be between \$1.20 and \$1.24. This EPS growth directly results from the revenue strength flowing through to profit.

Arm's guidance and outlook portray a company experiencing strong growth, with an upward revision in revenue forecasts for the fourth quarter and the entire year. The company anticipates continued strength in royalty revenue, particularly from its latest Armv9 products, and robust performance in its licensing business. Its optimistic outlook is underpinned by a diverse revenue base and sustained demand for its cutting-edge technologies.

ANALYSIS

Arm presents a compelling narrative of strategic growth and market adaptation. The company's latest earnings show a financial quarter that exceeded expectations and set a precedent for future growth.

Its strong performance is primarily driven by the successful transition to Armv9 products, which has effectively doubled the royalty rates compared to the previous generation of Armv8 products. Furthermore, Arm's strategic diversification into markets beyond mobile is paying dividends, contributing to a broader revenue base and reducing dependence on the smartphone sector.

The company's focus on AI-capable CPUs and Compute Subsystems aligns with the growing demand for advanced technologies in various sectors, signaling a sustainable growth trajectory.

Arm's ability to capitalize on these market trends and a robust product transition strategy position it as a resilient and forward-looking player in the technology industry. Arm's continued focus on innovation and market diversification will likely bolster its competitive edge and drive long-term success.



RESEARCH NOTE

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