

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended June 28, 2020.

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the transition period from _____ **to** _____

Commission file number: 000-50350

NETGEAR, Inc.

(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

**350 East Plumeria Drive,
San Jose, California**
(Address of principal executive offices)

77-0419172
*(IRS Employer
Identification No.)*

95134
(Zip Code)

(408) 907-8000

(Registrant's telephone number including area code)

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

Title of each class
Common Stock, \$0.001 par value

Trading symbol(s):
NTGR

Name of each exchange on which registered
The Nasdaq Stock Market LLC

Indicate by check mark whether the registrant (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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer	☐	Accelerated filer	☒
Non-Accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of outstanding shares of the registrant's Common Stock, \$0.001 par value, was 29,903,517 as of July 24, 2020.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands)

	As of	
	June 28, 2020	December 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 252,633	\$ 190,208
Short-term investments	5,919	5,499
Accounts receivable, net of allowance for doubtful accounts of \$1,079 as of June 28, 2020 and December 31, 2019	277,490	277,168
Inventories	150,585	235,489
Prepaid expenses and other current assets	35,061	35,745
Total current assets	721,688	744,109
Property and equipment, net	15,536	17,683
Operating lease right-of-use assets, net	31,774	28,917
Intangibles, net	6,915	10,104
Goodwill	80,721	80,721
Other non-current assets	72,337	74,279
Total assets	\$ 928,971	\$ 955,813
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 76,086	\$ 80,531
Accrued employee compensation	22,142	20,024
Other accrued liabilities	163,079	189,547
Deferred revenue	8,171	6,450
Income taxes payable	805	1,839
Total current liabilities	270,283	298,391
Non-current income taxes payable	15,505	15,307
Non-current operating lease liabilities	27,749	25,434
Other non-current liabilities	9,288	7,988
Total liabilities	322,825	347,120
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	30	30
Additional paid-in capital	853,137	831,365
Accumulated other comprehensive income	7	21
Accumulated deficit	(247,028)	(222,723)
Total stockholders' equity	606,146	608,693
Total liabilities and stockholders' equity	\$ 928,971	\$ 955,813

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NETGEAR, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
Net revenue	\$ 280,052	\$ 230,852	\$ 510,015	\$ 479,934
Cost of revenue	198,751	165,407	362,473	332,481
Gross profit	81,301	65,445	147,542	147,453
Operating expenses:				
Research and development	21,144	18,814	40,883	37,646
Sales and marketing	34,384	34,541	67,415	70,396
General and administrative	15,481	10,463	28,615	23,580
Other operating expenses, net	1,425	1,301	1,093	1,497
Total operating expenses	72,434	65,119	138,006	133,119
Income from operations	8,867	326	9,536	14,334
Interest income	49	782	311	1,483
Other income (expense), net	314	487	(4,272)	828
Income before income taxes	9,230	1,595	5,575	16,645
Provision for income taxes	3,247	756	3,765	2,963
Net income	\$ 5,983	\$ 839	\$ 1,810	\$ 13,682
Net income per share				
Basic	\$ 0.20	\$ 0.03	\$ 0.06	\$ 0.44
Diluted	\$ 0.20	\$ 0.03	\$ 0.06	\$ 0.42
Weighted average shares used to compute net income per share:				
Basic	29,617	31,246	29,608	31,365
Diluted	30,070	32,112	30,079	32,518

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NETGEAR, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
Net income	\$ 5,983	\$ 839	\$ 1,810	\$ 13,682
Other comprehensive income (loss), before tax:				
Change in unrealized gains and losses on derivatives	(418)	(2)	(15)	21
Change in unrealized gains and losses on available-for-sale investments	—	1	—	16
Other comprehensive income (loss), before tax	(418)	(1)	(15)	37
Tax benefit (provision) related to derivatives	54	—	1	(6)
Tax provision related to available-for-sale investments	—	(1)	—	(4)
Other comprehensive income (loss), net of tax	(364)	(2)	(14)	27
Comprehensive income	<u>\$ 5,619</u>	<u>\$ 837</u>	<u>\$ 1,796</u>	<u>\$ 13,709</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	<u>Common Stock</u>		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholder's Equity
	Shares	Amount				
Balance as of December 31, 2019	29,925	\$ 30	\$ 831,365	\$ 21	\$ (222,723)	\$ 608,693
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	350	—	350
Net loss	—	—	—	—	(4,173)	(4,173)
Stock-based compensation	—	—	6,336	—	—	6,336
Repurchase of common stock	(584)	—	—	—	(15,008)	(15,008)
Restricted stock unit withholdings	(54)	—	—	—	(1,347)	(1,347)
Issuance of common stock under stock-based compensation plans	305	—	2,940	—	—	2,940
Balance as of March 29, 2020	29,592	\$ 30	\$ 840,641	\$ 371	\$ (243,251)	\$ 597,791
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	(364)	—	(364)
Net income	—	—	—	—	5,983	5,983
Stock-based compensation	—	—	9,172	—	—	9,172
Repurchase of common stock	(315)	—	—	—	(7,500)	(7,500)
Restricted stock unit withholdings	(95)	—	—	—	(2,260)	(2,260)
Issuance of common stock under stock-based compensation plans	502	—	3,324	—	—	3,324
Balance as of June 28, 2020	29,684	\$ 30	\$ 853,137	\$ 7	\$ (247,028)	\$ 606,146

	<u>Common Stock</u>		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholder's Equity
	Shares	Amount				
Balance as of December 31, 2018	31,562	\$ 32	\$ 793,585	\$ (15)	\$ (166,050)	\$ 627,552
Change in unrealized gains and losses on available-for-sale investments, net of tax	—	—	—	12	—	12
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	17	—	17
Net income	—	—	—	—	12,843	12,843
Stock-based compensation	—	—	6,457	—	—	6,457
Repurchase of common stock	(436)	—	—	—	(15,000)	(15,000)
Restricted stock unit withholdings	(89)	—	—	—	(3,344)	(3,344)
Issuance of common stock under stock-based compensation plans	430	—	4,371	—	—	4,371
Balance as of March 31, 2019	31,467	\$ 32	\$ 804,413	\$ 14	\$ (171,551)	\$ 632,908
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	(2)	—	(2)
Net income	—	—	—	—	839	839
Stock-based compensation	—	—	6,739	—	—	6,739
Repurchase of common stock	(570)	(1)	—	—	(16,979)	(16,980)
Restricted stock unit withholdings	(79)	—	—	—	(2,314)	(2,314)
Issuance of common stock under stock-based compensation plans	292	—	882	—	—	882
Balance as of June 30, 2019	31,110	\$ 31	\$ 812,034	\$ 12	\$ (190,005)	\$ 622,072

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six Months Ended	
	June 28, 2020	June 30, 2019
Cash flows from operating activities:		
Net income	\$ 1,810	\$ 13,682
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,383	9,965
Stock-based compensation	15,508	13,197
Impairment of long-term investments	4,530	—
Deferred income taxes	2,867	2,116
Provision for excess and obsolete inventory	4,579	2,033
Other	89	(170)
Changes in assets and liabilities:		
Accounts receivable	(323)	65,032
Inventories	80,325	(34,478)
Prepaid expenses and other assets	1,031	(4,812)
Accounts payable	(4,791)	(29,083)
Accrued employee compensation	2,769	(8,229)
Other accrued liabilities	(27,052)	(37,161)
Deferred revenue	2,281	182
Income taxes payable	(836)	(2,201)
Net cash provided by (used in) operating activities	92,170	(9,927)
Cash flows from investing activities:		
Purchases of short-term investments	(147)	(149)
Proceeds from maturities of short-term investments	149	70,649
Purchases of property and equipment	(3,631)	(9,423)
Purchases of long-term investments	(6,265)	(5,200)
Net cash provided by (used in) investing activities	(9,894)	55,877
Cash flows from financing activities:		
Repurchases of common stock	(22,508)	(31,980)
Restricted stock unit withholdings	(3,607)	(5,658)
Proceeds from exercise of stock options	3,786	2,949
Proceeds from issuance of common stock under employee stock purchase plan	2,478	2,303
Net cash used in financing activities	(19,851)	(32,386)
Net increase in cash and cash equivalents	62,425	13,564
Cash and cash equivalents, at beginning of period	190,208	201,047
Cash and cash equivalents, at end of period	\$ 252,633	\$ 214,611

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1. The Company and Basis of Presentation**

NETGEAR, Inc. ("NETGEAR" or the "Company") was incorporated in Delaware in January 1996. The Company is a global company that delivers innovative, advanced high performance networking technologies and Internet connected products to consumers, businesses, and service providers. The Company's products are designed to simplify and improve people's lives. The Company's goal is to enable people to collaborate and connect to a world of information and entertainment. The Company is dedicated to delivering innovative and advanced connected solutions ranging from mobile and cloud-based services for enhanced control and security, to smart networking products, video over Ethernet for Pro AV applications, easy-to-use WiFi solutions and performance gaming routers to enhance console, online and cloud game play. The Company's products are built on a variety of technologies such as wireless (WiFi and 4G/5G mobile), Ethernet and powerline, with a focus on reliability and ease-of-use. Additionally, the Company continually invests in research and development to create new technologies and to capitalize on technological inflection points and trends, such as WiFi 6, 5G and Pro-AV. NETGEAR's product lines consist of devices that create and extend wired and wireless networks, devices that attach to the network, such as smart digital canvasses as well as services that complement and enhance our product line offerings. These products are available in multiple configurations to address the changing needs of the Company's customers in each geographic region.

The accompanying unaudited condensed consolidated financial statements include the accounts of NETGEAR, Inc. and its wholly owned subsidiaries. They have been prepared in accordance with established guidelines for interim financial reporting and the instructions of Form 10-Q and Article 10 of Regulation S-X. All significant intercompany balances and transactions have been eliminated in consolidation. The balance sheet dated December 31, 2019 has been derived from audited financial statements at such date. These unaudited condensed consolidated financial statements do not include all of the information and footnotes typically found in the audited consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K. In the opinion of management, the unaudited condensed consolidated financial statements reflect all normal recurring adjustments considered necessary to fairly state the Company's financial position, results of operations, comprehensive income, stockholder's equity and cash flows for the periods indicated. These unaudited condensed consolidated financial statements should be read in conjunction with the notes to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

The Company's fiscal year begins on January 1 of the year stated and ends on December 31 of the same year. The Company reports its interim results on a fiscal quarter basis rather than on a calendar quarter basis. Under the fiscal quarter basis, each of the first three fiscal quarters ends on the Sunday closest to the calendar quarter end, with the fourth quarter ending on December 31.

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared the COVID-19 outbreak a pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and work force participation and created significant volatility and disruption of financial markets. The COVID-19 pandemic may impact the Company's supply chain to timely produce finished goods, its workforce and the operations of its customers, and has led to increased airfreight rates. An extended period of global supply chain, workforce availability and economic disruption could significantly affect the Company's business and statement of financial condition, including the carrying value of long-lived assets, intangibles and goodwill. During the first fiscal quarter of 2020, the Company recognized an impairment charge of \$4.5 million, brought about by triggering events impacting the valuation of a number of its privately held long-term investments, partially due to the onset of the pandemic. The Company did not recognize any impairment pertaining to long-term investments in the three months ended June 28, 2020. While the duration of the disruption from the pandemic is uncertain, the dynamic nature of the virus makes it difficult to reasonably estimate the impact of COVID-19 on the Company's business operations.

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 (i) the reported amounts of assets and liabilities, (ii) the disclosure of contingent assets and liabilities at the date of the financial statements, and (iii) the reported amounts of net revenue and expenses during the reported period. The Company bases these estimates on historical and anticipated results, trends and various other assumptions that it believes are reasonable under the circumstances. As of the date of issuance of these condensed consolidated financial statements, the Company is not aware of any specific event or circumstance that would require it to update its estimates, judgments or revise the carrying value of its assets or liabilities. These estimates may change, as new events occur and additional information is obtained, and are recognized in the condensed consolidated financial statements as soon as they become known. Actual results could differ materially from those estimates and operating results for the three and six months ended June 28, 2020 are not necessarily indicative of the results that may be expected for the year ending December 31, 2020 or any future period.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Note 2. Summary of Significant Accounting Policies**

With the exception of the updates to the policy noted below as a result of the adoption of *ASU 2016-13 Financial Instruments-Credit Losses* as of January 1, 2020, there have been no new or material changes to the significant accounting policies disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Allowance for doubtful accounts

The Company maintains an allowance for doubtful accounts for estimated credit losses resulting from the inability of its customers to make required payments and reviews it quarterly. The Company determines expected credit losses by performing credit evaluations of its customers' financial condition, establishing specific reserves for customers in an adverse financial condition and adjusting for its expectations of changes in conditions that may impact the collectability of outstanding receivables. The Company considers factors such as historical experience, credit quality, age of the accounts receivable balances, and geographic or country-specific risks. If the financial condition of the Company's customers should deteriorate or if actual defaults are higher than the Company's historical experience, additional allowances may be required, which could have an adverse impact on operating expenses.

Recent accounting pronouncements***Accounting Pronouncements Recently Adopted******ASU 2016-13***

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments", which replaces the incurred-loss impairment methodology and requires immediate recognition of estimated credit losses expected to occur for most financial assets, including trade receivables. Credit losses on available-for-sale debt securities with unrealized losses will be recognized as allowances for credit losses limited to the amount by which fair value is below amortized cost. The Company adopted the new standard effective January 1, 2020, using a modified retrospective transition method, which requires a cumulative-effect adjustment, if any, to the opening balance of retained earnings to be recognized on the date of adoption with prior periods not restated. The adoption did not have any impact on the Company's financial position, results of operations or cash flows.

Accounting Pronouncements Not Yet Effective

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes", which removes certain exceptions related to intra-period tax allocations and deferred tax accounting on outside basis differences in foreign subsidiaries. Additionally, it provides other simplifying measures for the accounting for income taxes. ASU 2019-12 is effective for the Company in the first quarter of 2021 and early adoption is permitted. The Company does not anticipate a material impact from the adoption of the standard but continues to evaluate the impact of the new guidance on its financial position, results of operations and cash flows.

In March 2020, the FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting", which provides optional expedients and exceptions for a limited period of time to ease the potential burden in accounting treatments related to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. Adoption of the expedients and exceptions is elective and is permitted upon issuance of the guidance through December 31, 2022. The Company does not expect that the new guidance will have material impact on its financial position, results of operations and cash flows.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to the Company's financial position, results of operations and cash flows.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Note 3. Revenue**

Revenue from contracts with customers is recognized when control of the promised goods or services is transferred to the customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services.

Transaction Price Allocated to the Remaining Performance Obligations

Remaining performance obligations represent the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied as of the end of the reporting period. Unsatisfied and partially unsatisfied performance obligations consist of contract liabilities, in-transit orders with destination terms, and non-cancellable backlog. Non-cancellable backlog includes goods and services for which customer purchase orders have been accepted and that are scheduled or in the process of being scheduled for shipment.

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) as of June 28, 2020:

	<u>1 year</u>	<u>2 years</u>	<u>Greater than 2 years</u>	<u>Total</u>
	(In thousands)			
Performance obligations	\$ 141,156	\$ 1,543	\$ 1,132	\$ 143,831

Contract Balances

The Company records accounts receivable when it has an unconditional right to consideration. Contract liabilities are recorded when cash payments are received or due in advance of performance. Contract liabilities consist of advance payments and deferred revenue, where the Company has unsatisfied performance obligations. Contract liabilities are mainly classified as Deferred revenue on the unaudited condensed consolidated balance sheets.

Payment terms vary by customer. The time between invoicing and when payment is due is not significant. For certain products or services and customer types, payment is required before the products or services are delivered to the customer.

The following table reflects the contract balances as of June 28, 2020 and December 31, 2019, respectively:

	<u>Balance Sheet Location</u>	<u>June 28, 2020</u>	<u>December 31, 2019</u>
		(In thousands)	
Accounts receivable, net	Accounts receivable, net	\$ 277,490	\$ 277,168
Contract liabilities - current	Deferred revenue	\$ 8,171	\$ 6,450
Contract liabilities - non-current	Other non-current liabilities	\$ 2,621	\$ 2,061

The difference in the balances of the Company's contract assets and liabilities as of June 28, 2020 and December 31, 2019 primarily results from the timing difference between the Company's performance and the customer's payment.

During the six months ended June 28, 2020, \$8.8 million of revenue was deferred due to unsatisfied performance obligations for service contracts and undelivered product commitments, \$6.5 million of revenue was recognized for the satisfaction of performance obligations and \$4.4 million of this recognized revenue was included in the contract liability balance at the beginning of the period.

There were no significant changes in estimates during the period that would affect the contract balances.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Disaggregation of Revenue

In the following table, net revenue is disaggregated by geographic region and sales channel. The Company conducts business across three geographic regions: Americas; Europe, Middle-East and Africa ("EMEA"); and Asia Pacific ("APAC"). The table also includes a reconciliation of the disaggregated revenue by reportable segment. The Company operates and reports in two segments: Connected Home, and Small and Medium Business ("SMB"). Sales and usage-based taxes are excluded from net revenue.

	Three Months Ended					
	June 28, 2020			June 30, 2019		
	Connected Home	SMB	Total	Connected Home	SMB	Total
Geographic regions:						
Americas	\$ 179,810	\$ 22,436	\$ 202,246	\$ 131,669	\$ 25,501	\$ 157,170
EMEA	31,203	17,156	48,359	17,526	25,565	43,091
APAC	19,004	10,443	29,447	18,300	12,291	30,591
Total	<u>\$ 230,017</u>	<u>\$ 50,035</u>	<u>\$ 280,052</u>	<u>\$ 167,495</u>	<u>\$ 63,357</u>	<u>\$ 230,852</u>
Sales channels:						
Service provider	\$ 44,152	\$ 871	\$ 45,023	\$ 26,901	\$ 922	\$ 27,823
Non-service provider	185,865	49,164	235,029	140,594	62,435	203,029
Total	<u>\$ 230,017</u>	<u>\$ 50,035</u>	<u>\$ 280,052</u>	<u>\$ 167,495</u>	<u>\$ 63,357</u>	<u>\$ 230,852</u>

	Six Months Ended					
	June 28, 2020			June 30, 2019		
	Connected Home	SMB	Total	Connected Home	SMB	Total
Geographic regions:						
Americas	\$ 308,974	\$ 51,462	\$ 360,436	\$ 245,356	\$ 59,843	\$ 305,199
EMEA	49,174	41,333	90,507	43,216	56,838	100,054
APAC	36,532	22,540	59,072	48,288	26,393	74,681
Total	<u>\$ 394,680</u>	<u>\$ 115,335</u>	<u>\$ 510,015</u>	<u>\$ 336,860</u>	<u>\$ 143,074</u>	<u>\$ 479,934</u>
Sales channels:						
Service provider	\$ 70,839	\$ 1,668	\$ 72,507	\$ 63,719	\$ 2,398	\$ 66,117
Non-service provider	323,841	113,667	437,508	273,141	140,676	413,817
Total	<u>\$ 394,680</u>	<u>\$ 115,335</u>	<u>\$ 510,015</u>	<u>\$ 336,860</u>	<u>\$ 143,074</u>	<u>\$ 479,934</u>

Note 4. Balance Sheet Components
Available-for-sale short-term investments

	As of								
	June 28, 2020					December 31, 2019			
	Cost	Unrealized Gains	Unrealized Losses	Allowance for Credit Losses	Estimated Fair Value	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(In thousands)								
Certificates of deposit	\$ 147	\$ —	\$ —	\$ —	\$ 147	\$ 149	\$ —	\$ —	\$ 149
Convertible debt	1,326	—	—	—	1,326	1,326	—	—	1,326
Total	\$ 1,473	\$ —	\$ —	\$ —	\$ 1,473	\$ 1,475	\$ —	\$ —	\$ 1,475

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company's available-for-sale short-term investments are primarily comprised of convertible debt securities with an original maturity or remaining maturity at the time of purchase of greater than three months and no more than twelve months. Accordingly, none of the available-for-sale investments have unrealized losses greater than twelve months.

Inventories

	As of	
	June 28, 2020	December 31, 2019
	(In thousands)	
Raw materials	\$ 14,751	\$ 28,871
Finished goods	135,834	206,618
Total	<u>\$ 150,585</u>	<u>\$ 235,489</u>

The Company records provisions for excess and obsolete inventory based on assumptions about future demand and market conditions and the amounts incurred were \$2.2 million and \$4.6 million for the three and six months ended June 28, 2020, respectively, and \$1.1 million and \$2.0 million for the three and six months ended June 30, 2019, respectively. While management believes the estimates and assumptions underlying its current forecasts are reasonable, there is risk that additional charges may be necessary if current forecasts are greater than actual demand.

Property and equipment, net

	As of	
	June 28, 2020	December 31, 2019
	(In thousands)	
Computer equipment	\$ 10,376	\$ 9,883
Furniture, fixtures and leasehold improvements	18,134	18,623
Software	28,718	27,865
Machinery and equipment	67,268	59,637
Total property and equipment, gross	124,496	116,008
Accumulated depreciation and amortization	(108,960)	(98,325)
Total	<u>\$ 15,536</u>	<u>\$ 17,683</u>

Depreciation and amortization expense pertaining to property and equipment was \$3.2 million and \$6.2 million for the three and six months ended June 28, 2020, respectively, and \$3.2 million and \$6.1 million for the three and six months ended June 30, 2019, respectively.

Intangibles, net

	As of June 28, 2020			As of December 31, 2019		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(In thousands)					
Technology	\$ 59,799	\$ (57,621)	\$ 2,178	\$ 59,799	\$ (57,406)	\$ 2,393
Customer contracts and relationships	56,800	(52,978)	3,822	56,800	(50,297)	6,503
Other	10,345	(9,430)	915	10,345	(9,137)	1,208
Total	<u>\$ 126,944</u>	<u>\$ (120,029)</u>	<u>\$ 6,915</u>	<u>\$ 126,944</u>	<u>\$ (116,840)</u>	<u>\$ 10,104</u>

Amortization of intangibles was \$1.6 million and \$3.2 million for the three and six months ended June 28, 2020, respectively, and \$1.7 million and \$3.8 million for the three and six months ended June 30, 2019, respectively.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As of June 28, 2020, estimated amortization expense related to finite-lived intangibles for the remaining years is as follows (in thousands):

2020 (remaining six months)	\$	3,016
2021		2,044
2022		527
2023		514
2024		514
Thereafter		300
Total estimated amortization expense	\$	<u>6,915</u>

Other non-current assets

	As of	
	June 28, 2020	December 31, 2019
	(In thousands)	
Non-current deferred income taxes	\$ 56,065	\$ 58,930
Long-term investments	9,869	8,147
Other	6,403	7,202
Total	<u>\$ 72,337</u>	<u>\$ 74,279</u>

Long-term investments

The Company's long-term investments are primarily comprised of equity investments without readily determinable fair values. The changes in the carrying value of these investments during the following periods are as follows:

	Six Months Ended	
	June 28, 2020	June 30, 2019
	(In thousands)	
Carrying value as of the beginning of the period	\$ 8,147	\$ 2,886
Additions from purchase of investments	5,815	5,200
Impairment	(4,530)	—
Carrying value as of the end of the period ⁽¹⁾	<u>\$ 9,432</u>	<u>\$ 8,086</u>

⁽¹⁾ The balance as of June 28, 2020 did not include the investment in limited partnership fund of \$0.4 million.

The impairment recognized during the first fiscal quarter of 2020 was brought about by triggering events impacting the valuation of a number of its privately held long-term investments, partially due to the onset of the COVID-19 pandemic. No impairment pertaining to long-lived assets was recognized during the three months ended June 28, 2020. For the equity investments without readily determinable fair values as of June 28, 2020, cumulative downward adjustments for price changes and impairment was \$6.2 million and cumulative upward adjustments for price changes was \$0.2 million.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Other accrued liabilities

	As of	
	June 28, 2020	December 31, 2019
	(In thousands)	
Current operating lease liabilities	\$ 8,896	\$ 9,357
Sales and marketing	58,104	85,605
Warranty obligations	9,275	10,556
Sales returns ⁽¹⁾	49,107	52,612
Freight and duty	8,610	5,633
Other	29,087	25,784
Total	\$ 163,079	\$ 189,547

⁽¹⁾ Inventory expected to be received from future sales returns amounted to \$24.9 million and \$26.8 million as of June 28, 2020 and December 31, 2019, respectively. Provisions to write down expected returned inventory to net realizable value amounted to \$14.4 million and \$14.9 million as of June 28, 2020 and December 31, 2019, respectively.

Note 5. Derivative Financial Instruments

The Company's subsidiaries have material future cash flows related to revenue and expenses denominated in currencies other than the U.S. dollar, the Company's functional currency worldwide. The Company executes currency forward contracts that typically mature in less than 6 months to mitigate its currency risk, in currencies including Australian dollars, British pounds, euros, Canadian dollar, and Japanese yen. The Company does not enter into derivatives transactions for trading or speculative purposes.

The Company's foreign currency forward contracts do not contain any credit-risk-related contingent features. The Company enters into derivative contracts with high-quality financial institutions and limits the amount of credit exposure to any individual counter-party. The Company continuously evaluates the credit quality of its counter-party financial institutions and does not consider non-performance a material risk.

The Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including, but not limited to, materiality, accounting considerations or the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign exchange rates. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with the authoritative guidance for derivatives and hedging. The Company records all derivatives on the balance sheets at fair value. Cash flow hedge gains and losses are recorded in other comprehensive income ("OCI") until the hedged item is recognized in earnings. Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in Other income (expense), net in the unaudited condensed consolidated statements of operations.

Cash flow hedges

To help manage the exposure of operating margins to fluctuations in foreign currency exchange rates, the Company hedges a portion of its anticipated foreign currency revenue, costs of revenue and certain operating expenses. These hedges are designated at the inception of the hedge relationship as cash flow hedges under the authoritative guidance for derivatives and hedging. Effectiveness of the hedge relationships are tested at least quarterly both prospectively and retrospectively using regression analysis to ensure that the hedge relationship has been effective and is likely to remain effective in the future. The Company typically executes ten forward contracts per quarter with maturities under six months and with USD notional amount of approximately \$6.0 million each that are designated as cash flow hedges.

The Company expects to reclassify to earnings all of the amounts recorded in OCI associated with its cash flow hedges over the next twelve months. OCI associated with cash flow hedges of foreign currency revenue, cost of revenue and operating expenses are recognized in the same period and in the same line item in the statement of operations as hedged item. The Company did not recognize any material net gains or losses related to anticipated transactions that failed to occur during the three and six months ended June 28, 2020 and June 30, 2019.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Non-designated hedges

The Company enters into non-designated hedges under the authoritative guidance for derivatives and hedging to manage the exposure of non-functional currency monetary assets and liabilities not already hedged by de-designated cash flow hedges. The non-designated hedges are generally expected to offset the changes in value of its net non-functional currency asset and liability position resulting from foreign exchange rate fluctuations. The Company adjusts its non-designated hedges monthly and typically executes about ten non-designated forwards per quarter with maturities less than three months and a USD notional amount of approximately \$2.0 million.

Fair Value of Derivative Instruments

The fair values of the Company's derivative instruments and the line items on the unaudited condensed consolidated balance sheets to which they were recorded as of June 28, 2020, and December 31, 2019, are summarized as follows:

		Balance Sheet				Balance Sheet	
		Location	June 28, 2020	December 31, 2019	Location	June 28, 2020	December 31, 2019
		(In thousands)				(In thousands)	
Derivatives not designated as hedging instruments	Prepaid expenses and other current assets	\$	261	\$	109	Other accrued liabilities	\$ 1,336 \$ 493
Derivatives designated as hedging instruments	Prepaid expenses and other current assets		12		43	Other accrued liabilities	— 32
Total		\$	273	\$	152		\$ 1,336 \$ 525

Refer to Note 12, *Fair Value Measurements*, in Notes to Unaudited Condensed Consolidated Financial Statements for detailed disclosures regarding fair value measurements in accordance with the authoritative guidance for fair value measurements and disclosures.

Offsetting Derivative Assets and Liabilities

The Company has entered into master netting arrangements which allow net settlements under certain conditions. Although netting is permitted, it is currently the Company's policy and practice to record all derivative assets and liabilities on a gross basis on the unaudited condensed consolidated balance sheets. As of June 28, 2020, the Company holds and reports \$0.3 million of gross assets and \$1.3 million of gross liabilities. Net of offset, the Company holds no assets and \$1.0 million of liabilities.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Effect of Derivative Contracts on Consolidated Statement of Operations and Accumulated Other Comprehensive Income

The effect of the Company's derivative instruments on AOCI and the unaudited condensed consolidated statements of operations for the three and six months ended June 28, 2020 and June 30, 2019 are summarized as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
Derivatives designated as hedging instruments:				
<i>Cash flow hedges</i>				
Foreign currency forward contracts:				
Gains (losses) recognized in accumulated other comprehensive income-Effective Portion	\$ (63)	\$ 534	\$ 922	\$ 863
Gains (losses) reclassified from accumulated other comprehensive income into Income -Effective Portion ⁽¹⁾ :				
Net revenue	\$ 343	\$ 672	\$ 1,019	\$ 1,086
Cost of revenue	\$ 1	\$ (6)	\$ (1)	\$ (8)
Research and development	\$ 7	\$ (20)	\$ 5	\$ (46)
Sales and marketing	\$ 5	\$ (98)	\$ (72)	\$ (167)
General and administrative	\$ (1)	\$ (12)	\$ (14)	\$ (23)
Derivatives not designated as hedging instruments:				
Gains (losses) recognized in Other income (expense), net	\$ (1,128)	\$ 304	\$ 650	\$ 906

⁽¹⁾ Refer to Note 9, *Stockholders' Equity*, which summarizes the accumulated other comprehensive income activity related to derivatives.

Note 6. Net Income Per Share

Basic net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. Potentially dilutive common shares include common shares issuable upon exercise of stock options, vesting of restricted stock awards, and issuances of shares under the Employee Stock Purchase Plan (the "ESPP"), which are reflected in diluted net income per share by application of the treasury stock method. Potentially dilutive common shares are excluded from the computation of diluted net income per share when their effect is anti-dilutive.

Net income per share for the three and six months ended June 28, 2020 and June 30, 2019 are as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
(In thousands, except per share data)				
Numerator:				
Net income	\$ 5,983	\$ 839	\$ 1,810	\$ 13,682
Denominator:				
Weighted average common shares - basic	29,617	31,246	29,608	31,365
Potentially dilutive common share equivalent	453	866	471	1,153
Weighted average common shares - dilutive	30,070	32,112	30,079	32,518
Basic net income per share	\$ 0.20	\$ 0.03	\$ 0.06	\$ 0.44
Diluted net income per share	\$ 0.20	\$ 0.03	\$ 0.06	\$ 0.42
Anti-dilutive employee stock-based awards, excluded	2,245	1,208	2,425	692

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Note 7. Income Taxes**

The income tax provision for the three and six months ended June 28, 2020 was \$3.2 million, or an effective tax rate of 35.2%, and \$3.8 million, or an effective tax rate of 67.5%, respectively. The income tax provision for the three and six months ended June 30, 2019, was \$0.8 million, or an effective tax rate of 47.4%, and \$3.0 million, or an effective tax rate of 17.8%, respectively. The increase in tax expense for the three months ended June 28, 2020, compared to the prior year period, was due primarily to higher pre-tax earnings coupled with the negative impact of limitations on current and future stock-based compensation deductions for certain executive officers under IRC section 162(m). The increase in tax expense for the six months ended in June 28, 2020, compared to the prior year period, results primarily from an increase in valuation allowance on deferred tax assets from investment impairments where the deferred tax benefit is not considered more likely than not, as well as the impact of limitations on current and future stock-based compensation deductions for certain executive officers under IRC section 162(m). These increases to tax expense in the current year periods were partially offset by favorable tax benefits recorded in the six months ended June 30, 2019 related to settlement of tax audits.

The Company is subject to income taxes in the U.S. and numerous foreign jurisdictions. The future foreign tax rate could be affected by changes in the composition in earnings in countries with tax rates differing from the U.S. federal rate. The Company is under examination in various U.S. and foreign jurisdictions.

The Company files income tax returns in the U.S. federal jurisdiction as well as various state, local, and foreign jurisdictions. Due to the uncertain nature of ongoing tax audits, the Company has recorded its liability for uncertain tax positions as part of its long-term liability as payments cannot be anticipated over the next twelve months. The existing tax positions of the Company continue to generate an increase in the liability for uncertain tax positions. The liability for uncertain tax positions may be reduced for liabilities that are settled with taxing authorities or on which the statute of limitations could expire without assessment from tax authorities. The possible reduction in liabilities for uncertain tax positions in multiple jurisdictions in the next twelve months is approximately \$0.6 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities. The Company has been notified by the Internal Revenue Service in a letter dated July 13, 2020 that they will conduct an examination of the fiscal year ended December 31, 2018.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law in response to the COVID-19 pandemic. The CARES Act, among other provisions, includes provisions related to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating losses carryback periods, alternative minimum tax credit refunds, modification to net interest expense deduction limitation, and technical amendments to tax depreciation methods for qualified improvement property placed in service after December 31, 2017. The Company does not expect these provisions of The CARES Act to have a material impact to income taxes or liquidity.

Note 8. Commitments and Contingencies**Purchase Obligations**

The Company has entered into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. For those orders not governed by master purchase agreements, the commitments are governed by the commercial terms on the Company's purchase orders subject to acknowledgment from its suppliers. As of June 28, 2020, the Company had approximately \$124.4 million in non-cancelable purchase commitments with suppliers. The Company establishes a loss liability for all products it does not expect to sell for which it has committed purchases from suppliers. Such loss liability was included in Other accrued liabilities on the Company's unaudited condensed consolidated balance sheets. From time to time the Company's suppliers procure unique complex components on the Company's behalf. If these components do not meet specified technical criteria or are defective, the Company should not be obligated to purchase the materials. However, disputes may arise as a result and significant resources may be spent resolving such disputes.

Non-Trade Commitments

As of June 28, 2020, the Company had long term, non-cancellable purchase commitments of \$15.8 million pertaining to non-trade activities.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Warranty Obligations**

Changes in the Company's warranty obligations, which is included in Other accrued liabilities on the unaudited condensed consolidated balance sheets, are as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
Balance as of beginning of the period	\$ 9,923	\$ 12,531	\$ 10,556	\$ 14,412
Provision for warranty liability made	1,528	2,131	3,211	3,412
Settlements made	(2,176)	(2,749)	(4,492)	(5,911)
Balance as of the end of the period	<u>\$ 9,275</u>	<u>\$ 11,913</u>	<u>\$ 9,275</u>	<u>\$ 11,913</u>

Guarantees and Indemnifications

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a Director and Officer Insurance Policy that enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of each indemnification agreement is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of June 28, 2020.

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers (the "Indemnified Parties") for any expenses or liability resulting from claimed infringements by the Company's products of patents, trademarks or copyrights of third parties that are asserted against the Indemnified Parties, subject to customary carve outs. The terms of these indemnification agreements are generally perpetual after execution of the agreement. The maximum amount of potential future indemnification is generally unlimited. From time to time, the Company receives requests for indemnity and may choose to assume the defense of such litigation asserted against the Indemnified Parties. The Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of June 28, 2020.

Employment Agreements

The Company has signed various change in control and severance agreements with key executives. Upon a termination without cause or resignation with good reason, executive officers would be entitled to (1) cash severance equal to the executive officer's annual base salary, and, for the Chief Executive Officer, an additional amount equal to his target annual bonus, (2) 12 months of health benefits continuation and (3) accelerated vesting of any unvested equity awards that would have vested during the 12 months following the termination date. Upon a termination without cause or resignation with good reason that occurs during the one month prior to or 12 months following a change in control of the Company, executive officers would be entitled to (1) cash severance equal to a multiple (2x for the Chief Executive Officer and 1x for all other executive officers) of the sum of the executive officer's annual base salary and target annual bonus, (2) a number of months (24 for the Chief Executive Officer and 12 for other executive officers) of health benefits continuation and (3) accelerated vesting of all outstanding, unvested equity awards. Severance is conditioned upon the execution and non-revocation of a release of claims. The change in control and severance agreements do not provide for any excise tax gross ups. If the merger-related payments or benefits of the executive officer are subject to the 20% excise tax under Section 4999 of the tax code, then the executive officer will either receive all such payments and benefits subject to the excise tax or such payments and benefits will be reduced so that the excise tax does not apply, whichever approach yields the best after-tax outcome for the executive officer. The Company had no liabilities recorded for these agreements as of June 28, 2020.

Litigation and Other Legal Matters

The Company is involved in disputes, litigation, and other legal actions, including, but not limited to, the matters described below. In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range, only if there is not a better estimate than any other amount within the range, as a component of legal expense within litigation reserves, net. The Company monitors developments in these legal matters that could affect the estimate the Company had previously accrued. In relation to such matters, the Company currently believes that there are no existing claims or proceedings that are likely to have a material adverse effect on its financial position within the next twelve months, or the outcome of these matters is currently not determinable. There are many uncertainties associated with any litigation, and these actions or other third-party claims against the Company may cause the Company to incur costly litigation and/or substantial settlement charges. In addition, the resolution of any intellectual property litigation may require the Company to make royalty payments, which could have an adverse effect in future periods. If any of those events were to occur, the Company's business, financial condition, results of operations, and cash flows could be adversely affected. The actual liability in any such matters may be materially different from the Company's estimates, which could result in the need to adjust the liability and record additional expenses.

Agenzia Entrate Provinciale Revenue Office 1 of Milan v. NETGEAR International, Inc.

In November 2012, the Italian tax police began a comprehensive tax audit of NETGEAR International, Inc.'s Italian Branch. The scope of the audit initially was from 2004 through 2011 and was subsequently expanded to include 2012. The tax audit encompassed Corporate Income Tax (IRES), Regional Business Tax (IRAP) and Value-Added Tax (VAT). In December 2013, December 2014, August 2015, and December 2015 an assessment was issued by Inland Revenue Agency, Provincial Head Office No. 1 of Milan-Auditing Department (Milan Tax Office) for the 2004 tax year, the 2005 through 2007 tax years, the 2008 through 2010 tax years, and the 2011 through 2012 tax years, respectively.

In May 2014, the Company filed with the Provincial Tax Court of Milan an appeal brief, including a Request for Hearing in Open Court and Request for Suspension of the Tax Assessment for the 2004 year. The hearing was held and decision was issued on December 19, 2014. The Tax Court decided in favor of the Company and nullified the assessment by the Inland Revenue Agency for 2004. The Inland Revenue Agency appealed the decision of the Tax Court on June 12, 2015. The Company filed its counter appeal with respect to the 2004 year during September 2015. On February 26, 2016, the Regional Tax Court conducted the appeals hearing for the 2004 year, ruling in favor of the Company. On June 13, 2016, the Inland Revenue Agency appealed the decision to the Supreme Court. The Company filed a counter appeal on July 23, 2016 and is awaiting scheduling of the hearing.

In June 2015, the Company filed with the Provincial Tax Court of Milan an appeal brief including a Request for Hearing in Open Court and Request for Suspension of the Tax Assessment for the 2005 through 2006 tax years. The hearing for suspension was held and the Request for Suspension of payment was granted. The hearing for the validity of the tax assessment for 2005 and 2006 was held in December 2015 with the Provincial Tax Court issuing its decision in favor of the Company. The Inland Revenue Agency filed its appeal with the Regional Tax Court. The Company filed its counter brief on September 30, 2016 and the hearing was held on March 22, 2017. A decision favorable to the Company was issued by the Court on July 5, 2017. The Italian Tax Authority has appealed the decision to the Supreme Court and the Company has responded with a counter appeal brief on December 3, 2017 and awaits scheduling of the hearing.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The hearing for the validity of the tax assessment for 2007 was held on March 10, 2016 with the Provincial Tax Court who issued its decision in favor of the Company on April 7, 2016. The Inland Revenue Agency has filed its appeal to the Regional Tax Court and the Company has submitted its counter brief. The hearing was held on November 17, 2017 and the Company received a positive decision on December 11, 2017. On June 11, 2018, the Italian government filed its appeal brief with the Supreme Court, and the Company filed its counter brief on July 12, 2018 and awaits scheduling of the hearing.

With respect to 2008 through 2010, the Company filed its appeal briefs with the Provincial Tax Court in October 2015 and the hearing for the validity of the tax assessments was held on April 21, 2016. A decision favorable to the Company was issued on May 12, 2016. The Inland Revenue Agency has filed its appeal to the Regional Tax Court. The Company filed its counter brief on February 5, 2017. The hearing was held on May 21, 2018, and the Company received a favorable decision on June 12, 2018. On October 14, 2019, Milan Tax Office filed an appeal with the Supreme Court. The Company filed its counter brief with the Supreme Court on November 22, 2019 and awaits scheduling of the hearing.

With respect to 2011 through 2012, the Company has filed its appeal brief on February 26, 2016 with the Provincial Tax Court to contest the relevant tax assessments. The hearing for suspension was held and the Request for Suspension of payment was granted. On October 13, 2016, the Company filed its final brief with the Provincial Tax Court. The hearing was held on October 24, 2016 and a decision favorable to the Company was issued by the Court. The Inland Revenue Agency appealed the decision before the Regional Tax Court. The Regional Tax Court heard the case on February 26, 2019 for both years and issued a decision favorable to the Company on March 11, 2019. On October 14, 2019, Milan Tax Office filed an appeal with the Supreme Court. The Company filed its counter brief with the Supreme Court on November 22, 2019 and awaits scheduling of the hearing.

With regard to all tax years, it is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Via Vadis v. NETGEAR, Inc.

On August 22, 2014, the Company was sued by Via Vadis, LLC and AC Technologies, S.A. (“Via Vadis”), in the Western District of Texas. The complaint alleges that the Company’s ReadyNAS and Stora products “with built-in BitTorrent software” allegedly infringe three related patents of Via Vadis (U.S. Patent Nos. 7,904,680, RE40, 521, and 8,656,125). Via Vadis filed similar complaints against Belkin, Buffalo, Blizzard, D-Link, and Amazon.

By referring to “built-in BitTorrent software,” the Company believes that the complaint is referring to the BitTorrent Sync application, which was released by BitTorrent Inc. in spring of 2014. At a high-level, the application allows file synchronization across multiple devices by storing the underlying files on multiple local devices, rather than on a centralized server. The Company’s ReadyNAS products do not include BitTorrent software when sold. The BitTorrent application is provided as one of a multitude of potential download options, but the software itself is not included on the Company’s devices when shipped. Therefore, the only viable allegation at this point is an indirect infringement allegation.

On November 10, 2014, the Company answered the complaint denying that it infringes the patents in suit and also asserting the affirmative defenses that the patents in suit are invalid and barred by the equitable doctrines of laches, waiver, and/or estoppel.

On February 6, 2015, the Company filed its motion to transfer venue from the Western District of Texas to the Northern District of California with the Court; on February 13, 2015, Via Vadis filed its opposition to the Company’s motion to transfer; and on February 20, 2015, the Company filed its reply brief on its motion to transfer. In early April 2015, the Company received the plaintiff’s infringement contentions, and on June 12, 2015, the defendants served invalidity contentions. On July 30, 2015, the Court granted the Company’s motion to transfer venue to the Northern District of California. In addition, the Company learned that Amazon and Blizzard filed petitions for the inter partes reviews (“IPRs”) for the patents in suit. On October 30, 2015, the Company and Via Vadis filed a joint stipulation requesting that the Court vacate all deadlines and enter a stay of all proceedings in the case pending the Patent Trial and Appeal Board’s final non-appealable decision on the IPRs initiated by Amazon and Blizzard. On November 2, 2015, the Court granted the requested stay. On March 8, 2016, the Patent Trial and Appeal Board issued written decisions instituting the IPRs jointly filed by Amazon and Blizzard. In early March of 2017, The Patent Trial and Appeal Board (PTAB) issued various decisions regarding Amazon’s and Blizzard’s IPRs of the patents in suit. One of the IPRs of the '125 patent resulted in a finding by the PTAB that Amazon and Blizzard had failed to show invalidity.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The second IPR on the '125 patent, however, resulted in cancellation of all claims asserted in Via Vadis's suit against the Company. Reissue '521 did not have any claims found invalid by the PTAB, and some dependent claims of the '680 patent survived the IPRs, and some claims of the '680 patent were canceled. Via Vadis has completed its appeal of the PTAB decisions on the IPRs, which were affirmed by the Federal Circuit. Meanwhile, the W.D. Texas Court issued a claim construction order finding the '680 patent indefinite. The parties in the W.D. of Texas case lifted their stay and Via Vadis filed a motion for reconsideration of the Court's finding of indefiniteness, which the Court has denied.

On August 8, 2019, Via Vadis filed its notice of appeal to the Federal Circuit in the W.D. Texas cases. The Company's case in N.D. California will remain stayed during the pendency of the appeal.

On July 8, 2020, the Federal Circuit issued its opinion in the appeal of the Via Vadis cases pending in the W.D. of Texas against Amazon and Blizzard. The appellate court affirmed-in-part and reversed-in-part. The Company expects that the stay in the Company's case in N.D. California will be lifted and the Court will likely set a case management conference in the coming months.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Chrimar Systems, Inc. v NETGEAR, Inc.

On July 1, 2015, the Company was sued by a non-practicing entity named Chrimar Systems, Inc., doing business as CMS Technologies and Chrimar Holding Company, LLC (collectively, "CMS"), in the Eastern District of Texas for allegedly infringing four patents-U.S. Patent Nos. 8,155,012 (the "'012 Patent"), entitled "System and method for adapting a piece of terminal equipment"; 8,942,107 (the "'107 Patent"), entitled "Piece of ethernet terminal equipment"; 8,902,760 (the "'760 Patent"), entitled "Network system and optional tethers"; and 9,019,838 (the "'838 Patent"), entitled "Central piece of network equipment" (collectively "patents-in-suit").

The patents-in-suit relate to using or embedding an electrical DC current or signal into an existing Ethernet communication link in order to transmit additional data about the devices on the communication link, and the specifications for the patents are identical. It appears that CMS has approximately 40 active cases in the Eastern District of Texas, as well as some cases in the Northern District of California on the patents-in-suit and the parent patent to the patents-in-suit.

The Company answered the complaint on September 15, 2015. On November 24, 2015, CMS served its infringement contentions on the Company, and CMS is generally attempting to assert that the patents in suit cover the Power over Ethernet standard (802.3af and 802.3at) used by certain of the Company's products.

On December 3, 2015, the Company filed with the Court a motion to transfer venue to the District Court for the Northern District of California and their memorandum of law in support thereof. On December 23, 2015, CMS filed its response to the Company's motion to transfer, and, on January 8, 2016, the Company filed its reply brief in support of its motion to transfer venue. On January 15, 2016, the Court granted the Company's motion to transfer venue to the District Court for the Northern District of California. The initial case management conference in the Northern District of California occurred on May 13, 2016, and on August 19, 2016, the parties exchanged preliminary claim constructions and extrinsic evidence. On August 26, 2016, the Company and three defendants in other Northern District of California CMS cases (Juniper Networks, Inc., Ruckus Wireless, Inc., and Fortinet, Inc.) submitted motions to stay their cases. The defendants in part argued that stays were appropriate pending the resolution of the currently-pending IPRs of the patents-in-suit before the Patent Trial and Appeal Board (PTAB), including four IPR Petitions filed by Juniper. On September 9, 2016, CMS submitted its opposition to the motions to stay the cases. On September 26, 2016, the Court ordered the cases stayed in their entirety, until the PTAB reaches institution decisions with respect to Juniper's four pending IPR petitions. Juniper's four IPR petitions were instituted by the PTAB in January 2017, and the Company subsequently moved to join the IPR petitions as an "understudy" to Juniper, only assuming a more active role in the petitions in the event Juniper settles with CMS. For all four patents in suit against the Company, the PTAB ordered that (a) the Petitioners' (the Company, Ruckus, and Brocade) Motion for Joinder to the Juniper IPRs is granted; (b) the Petitioners IPRs are instituted on the same grounds as in the Juniper IPRs and Petitioners are joined with the Juniper IPRs; and (c) all further filings by Petitioners in the joined proceedings will be in the Juniper IPRs. On December 21, 2017, the PTAB issued the first of the four Final Written Decisions in the IPRs filed by the Company on the patents in suit, ruling that the claims of the '107 Patent asserted by Chrimar were invalid. This was quickly followed by two more Final Written Decisions -- on January 3, 2018, the '838 patent's asserted claims were ruled invalid, and on January 23, 2018 the '012 patent's asserted claims were ruled invalid. Chrimar has 30 days from each Final

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Written Decision to seek a rehearing at the PTAB and 63 days from each to file an appeal. On April 26, 2018, the PTAB issued its decision invalidating all of the claims of the '760 patent challenged in the IPR. The PTAB's reasoning was similar to the reasoning set forth in the PTAB's previous decisions on the 012, 107 and 838 patents. The '760 patent claims were, however, amended by Chrimar during the pendency of the '760 IPR, and the PTAB did not rule on the validity of the amended claims, as they were not challenged in the original IPR Petitions (they couldn't have been because the Chrimar amendments had not yet happened). On June 6, 2018, Chrimar's appeals on all 4 written decisions by the USPTO invalidating all challenged claims were consolidated. The parties have completed briefing the matter and are awaiting schedule for oral argument before the Federal Circuit.

On September 3, 2019, the Company and other defendants conducted their oral argument before the Federal Circuit Court of Appeals. On September 19, 2019, the Federal Circuit affirmed the USPTO's decisions on defendants' IPRs invalidating all of the challenged claims.

On December 19, 2019, Chrimar petitioned the Supreme Court to review the Federal Circuit Court's decision invalidating all of the challenged claims in the IPRs. On February 24, 2020, the Supreme Court denied Chrimar's final appeal of the invalidity decisions from the IPRs.

After lifting the stay of the N.D. of California case, the Court held a case management conference on April 24, 2020 and allowed Chrimar to pursue two sets of new claims: (1) claims from the '760 Patent that Chrimar amended during an ex parte reexam filed by an unknown party during the pendency of the IPRs, and (2) claims of a new patent, the '825 Patent (also related to POE), but denied Chrimar's right to add a new claim from the '107 Patent where all of the asserted claims were previously invalidated by the PTO. The Company filed motions for summary judgment on both sets of claims (of the '760 and '825 Patents) and is awaiting the Court's ruling.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Vivato v. NETGEAR, Inc.

On April 19, 2017, the Company was sued by XR Communications (d/b/a) Vivato ("Vivato") in the United States District Court, Central District of California.

Based on its complaint, Vivato purports to be a research and development and product company in the WiFi area, but it appears that Vivato is not currently a manufacturer of commercial products. The three (3) patents that Vivato asserts against the Company are U.S. Patent Nos. 7,062,296, 7,729,728, and 6,611,231. The '296 and '728 patents are entitled "Forced Beam Switching in Wireless Communication Systems Having Smart Antennas." The '231 patent is entitled "Wireless Packet Switched Communication Systems and Networks Using Adaptively Steered Antenna Arrays." Vivato also has recently asserted the same patents in the Central District of California against D-Link, Ruckus, and Aruba, among others.

According to the complaint, the accused products include WiFi access points and routers supporting MU-MIMO, including without limitation access points and routers utilizing the IEEE 802.11ac-2013 standard. The accused technology is standards-based, and more specifically, based on the transmit beamforming technology in the 802.11ac WiFi standard.

The Company answered an amended complaint on July 7, 2017. In its answer, the Company objected to venue and recited that objection as a specific affirmative defense, so as to expressly reserve the same. The Company also raised several other affirmative defenses in its answer.

On August 28, 2017, the Company submitted its initial disclosures to the plaintiff. The initial scheduling conference was on October 2, 2017, and the Court set five day jury trial for March 19, 2019 for the leading Vivato/D-Link case, meaning the Company's trial date will be at some point after March 19, 2019.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

On March 20, 2018, the Company and other defendants in the various Vivato cases moved the Court to stay the case pending various IPRs filed on all of the patents in suit. Every asserted claim of all three patents-in-suit is now subject to challenge in IPRs that are pending before the U.S. Patent and Trial Appeal Board ("PTAB"). In particular, the Company, Belkin, and Ruckus are filing one set of IPRs on the three patents in suit; Cisco is filing another set of independent IPRs on the three patents in suit; and Aruba is filing yet another set of independent IPRs on the three patents in suit. On April 11, 2018, the Court granted the motion to stay pending filing of the IPRs. On May 3, 2018, the Company and other defendants filed their IPRs. The PTAB instituted the IPRs for the '296 and '728 patents, but not the '231 patent from the Ruckus and Belkin set of petitions. However, the Cisco IPR for the '231 patent was instituted. Vivato has proposed amendments to its claims and the parties have completed briefing the matter before the PTAB.

In July and August of 2019, the Company and other defendants had two oral arguments before the PTAB regarding the '296 and '728 patents. The PTAB denied institution of petition for the '231 Patent. On October 10, 2019, the PTAB issued a Final Written Decision invalidating all of the original claims at issue in the '296 Patent and denied Vivato's motion to amend (the claims).

In November 2019, the PTAB issued a Final Written Decision invalidating all of the challenged claims in the '728 Patent. In the meantime, the PTAB's Final Written Decision in the Cisco IPR of the '231 Patent found the claims to be valid and Cisco is appealing the finding. The Company anticipates that the Company's case will remain stayed through Cisco's appeal.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Hera Wireless v. NETGEAR, Inc.

On July 14, 2017, the Company was sued by Sisvel (via Hera Wireless) in the District of Delaware on three related patents allegedly covering the 802.11n standard. Similar complaints were filed against Amazon, ARRIS, Belkin, Buffalo, and Roku. On December 12, 2017, the Company answered the complaint, denying why each claim limitation of the patents in suit were allegedly met and asserting various affirmative defenses, including invalidity and noninfringement. A proposed joint Scheduling Order was submitted to the Court on January 24, 2018 with trial proposed for March of 2020.

On February 27, 2018, Hera Wireless identified the accused products and the asserted claims, alleging that any 802.11n compliant product infringes, and identified only the Company's Orbi and WND930 products with particularity. Hera Wireless' infringement contentions were submitted on April 28, 2018. Discovery is ongoing.

On June 28, 2018, the Company and other defendants submitted invalidity contentions. The Company along with other defendants jointly filed IPRs challenging three of the patents in suit on July 18, 2018. On September 14, 2018, the Company and other defendants jointly filed a second set of IPRs with the USPTO challenging the remaining six patents asserted in the Amended Complaint.

All of the instituted IPRs have been decided in defendants' favor, thereby canceling all claims for 8 of the 9 asserted patents. Hera appealed all of the adverse decisions to the Federal Circuit, and the appeals have been consolidated for the same patents for all defendants. Hera's opening briefs are due in mid-August 2020. The district court case remains stayed.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

John Pham v. Arlo Technologies, Inc., NETGEAR Inc., et al., and other related actions

On January 9, 2019 and January 10, 2019, February 1, 2019 and February 8, 2019, the Company was sued in four separate securities class action suits in Superior Court of California, County of Santa Clara, along with Arlo Technologies, individuals, and underwriters involved in the spin-off of Arlo. Two more similar state actions have been filed against Arlo Technologies Inc. et al.. In total, six putative class action complaints have now been filed in California state court in Santa Clara County. The Company is named as a defendant in five of the six lawsuits. The complaints generally allege that Arlo's IPO materials contained false and misleading statements, hiding problems with Arlo's Ultra product. These claims are styled as violations of Sections 11, 12(a), and 15 of the Securities Act of 1933.

There is also a putative class action pending in federal court in the Northern District of California, on behalf of the same class of plaintiffs, making very similar claims. The Company is not presently named in the federal action. Defendants

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

filed motions to stay the state court actions in deference to the federal court action. The court held a hearing on April 26, 2019 to consider whether to consolidate the six lawsuits and appoint a “lead plaintiff” and another hearing on May 31, 2019 to consider defendants’ motions to stay the state court cases. On June 21, 2019, the California state court judge granted the Company’s motion to stay the state court case pending the outcome of the federal case. The case will now proceed only in federal court.

On August 6, 2019, all the defendants, including NETGEAR, filed a motion to dismiss the federal court action. Plaintiffs filed their opposition brief on September 6, 2019 and defendants filed a reply on October 4, 2019. The motion is set for hearing on December 5, 2019. The state court action remains stayed pending the outcome of the federal action.

On November 18, 2019, the parties participated in mediation, but did not settle the case. On December 5, 2019, the court held a hearing on the defendants’ motion to dismiss, and on December 19, 2019, granted that motion as to all counts, with leave to amend. The Parties are currently discussing settlement. On February 14, 2020, the Court granted the Parties’ stipulation to stay proceedings to permit filing of a motion for preliminary approval for classwide settlement.

On June 11, 2020, the Parties signed the Stipulation and Settlement Agreement. On June 12, 2020, lead attorney for plaintiffs filed a motion with the Court for Preliminary Approval of the Class Action Settlement. If the motion is granted, the Parties will proceed with the required procedures before the Settlement Hearing to be set by the Court.

It is too early to reasonably estimate any financial impact to the Company resulting from these matters.

China Patent Matters - Beijing and Heifei Municipalities

On or around May 14, 2019, NETGEAR Beijing Network Technology Co. Ltd (“Beijing WOFE”) received notice from the Beijing Municipal IP Office (BMOIPO) that petitioner Global Innovation Aggregators, a Delaware registered company (“Patentee”), filed two patent infringement complaints against Beijing WOFE, alleging infringement of two patents: China Patent Nos. CN100502338C and CN103138979B. The accused products were certain Company routers sold in China. Patentee alleges that the Dynamic Quality of Service (“QoS”) or dynamic bandwidth adjustment and allocation functionality in the routers infringes CN100502338C, and the parental control functionality infringes CN103138979B. The Company hired local counsel who has responded to the Beijing matters and separately filed invalidation actions against both patents.

On or around July 2, 2019, the Company received notice that the Patentee also filed petitions against a NETGEAR reseller, Heifei Wanghang Network Technology Co., Ltd., before the Heifei Municipal IP Office, asserting the same patents against the Company’s routers. The Company has filed similar invalidation actions in the Heifei cases and requested that the Heifei IP Office stay the infringement cases pending outcome of the Beijing matters.

On October 12, 2019, the Company attended oral hearings for the infringement and invalidity cases for CN103138979B related to the parental control functionalities before the BMOIPO, and the invalidity case for the same patent before the Heifei IPO. The Company has since received a notice that the Plaintiff withdrew the infringement case for Patent CN100502338C related to QoS functionality before the BMOIPO. The invalidity cases for the QoS patent before both Beijing and Heifei IPO’s remain pending and the Company is awaiting notice(s) for oral hearing(s). The two Heifei infringement cases remain stayed pending resolution of the BMOIPO infringement cases.

In October 2019, plaintiff withdrew its infringement case for CN100502338C in Beijing, and in December 2019, it withdrew both infringement cases in Heifei. The only remaining infringement case is the one covering CN103138979B in Beijing, for which the parties are awaiting BMOIPO’s decision. In October and November 2019, the Company completed all four of its invalidity hearings on both patents before the Beijing and Heifei IP offices. Decisions on all four cases remain pending in both offices.

As of April 10, 2020, three of the four infringement cases were withdrawn by the Patentee and the patent in the fourth case was invalidated by the China IP Office. The Parties are awaiting the decision from the hearing on patent CN103138979B. Patentee has three months from the date of the invalidation decision to appeal to the Beijing IP Court. .

On June 3, 2020, the Beijing Intellectual Property Office found non-infringement of the CN103138979B patent by the Company. Plaintiff did not appeal, thereby concluding these matters all in the Company’s favor without any material impact to the Company.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Aegis 11 S.A. v. NETGEAR Inc.

On June 21, 2019, Aegis 11 S.A. (“Aegis”) sued NETGEAR and several other defendants for patent infringement in the District of Delaware. Aegis asserted that NETGEAR’s WiFi routers infringe three patents related to the 802.11 standard: U.S. Patent No. 6,839,553, U.S. Patent No. 9,584,200, and U.S. Patent No. 9,848,443.

In lieu of filing its Answer on October 15, 2019, the Company filed a partial motion to dismiss against one of the asserted claims based on unpatentable subject matter. The Company’s Answer will not be due until the motion to dismiss is decided.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Cassiopeia v. NETGEAR, Inc.

Cassiopeia IP LLC sued the Company in the District of Delaware, on December 21, 2019, alleging infringement of U.S. Patent No. 7,322,046, entitled “Method and System for the Secure Use of a Network Service.” The accused product is the NeoTV MAX Streaming Player.

On March 2, 2020, the Company filed an Answer in the case. On March 11, 2020, the Court granted a stipulation to stay the case pending the result of an IPR filed by United Patents Inc.

Cassiopeia and United Patents settled their IPR dispute in June 2020. The Company expects that the stay on the Company’s district court case will likely be lifted in the coming months.

It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.

Donjun Technology v. NETGEAR (China Patent Matters)

On or around July 2, 2020, Company received notice from its local litigation counsel in China that a Chinese Non-Practicing Entity (NPE) brought an infringement action against its Beijing office before the Beijing Municipal Intellectual Property Office (BMIPO). The action alleges that NETGEAR WAC510 and other devices infringe Chinese patent ZL02123502.3 (the ‘502 Patent). Company’s local counsel received service on the Company’s behalf on or around July 20, 2020.

In addition, local counsel was informed by the BMIPO that Donjun filed a separate patent suit against NETGEAR Inc., the Company’s U.S. headquarters, before the Shanghai IP Court. The Company is awaiting service for this matter, though it may take some time to complete as it must be done via the Hague Convention. In the meantime, the Company will proceed with its Beijing case.

It is too early to reasonably estimate any financial impact to the Company resulting from this matter.

Note 9. Stockholders' Equity

Stock Repurchases

From time to time, the Company’s Board of Directors has authorized programs under which the Company may repurchase shares of its common stock, depending on market conditions, in the open market or through privately negotiated transactions. Under the authorizations, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and the price of the Company’s common stock. As of June 28, 2020, 2.7 million shares remained authorized for repurchase under the repurchase program. In the six months ended June 28, 2020 and June 30, 2019, the Company repurchased, reported based on trade date, approximately 0.9 million shares and 1.0 million shares of common stock, respectively, at a cost of approximately \$22.5 million and \$32.0 million, respectively, under the repurchase authorization.

The Company repurchased, as reported based on trade date, approximately 149,000 shares of common stock at a cost of \$3.6 million and approximately 168,000 shares of common stock at a cost of \$5.7 million, to administratively facilitate the

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the six months ended June 28, 2020 and June 30, 2019, respectively.

These shares were retired upon repurchase. The Company's policy related to repurchases of its common stock is to charge the excess of cost over par value to retained earnings. All repurchases were made in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

Accumulated Other Comprehensive Income

The following table sets forth the changes in accumulated other comprehensive income ("AOCI") by component during the six months ended June 28, 2020 and June 30, 2019:

	Unrealized gains (losses) on available -for-sale investments	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
	(In thousands)			
Balance as of December 31, 2019	\$ (2)	\$ 22	\$ 1	\$ 21
Other comprehensive income (loss) before reclassifications	—	922	(196)	726
Less: Amount reclassified from accumulated other comprehensive income	—	937	(197)	740
Net current period other comprehensive income (loss)	—	(15)	1	(14)
Balance as of June 28, 2020	<u>\$ (2)</u>	<u>\$ 7</u>	<u>\$ 2</u>	<u>\$ 7</u>

	Unrealized gains (losses) on available -for-sale investments	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
	(In thousands)			
Balance as of December 31, 2018	\$ (18)	\$ (8)	\$ 11	\$ (15)
Other comprehensive income (loss) before reclassifications	16	863	(187)	692
Less: Amount reclassified from accumulated other comprehensive income	—	842	(177)	665
Net current period other comprehensive income (loss)	16	21	(10)	27
Balance as of June 30, 2019	<u>\$ (2)</u>	<u>\$ 13</u>	<u>\$ 1</u>	<u>\$ 12</u>

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables provide details about significant amounts reclassified out of each component of AOCI for the three and six months ended June 28, 2020 and June 30, 2019:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
(In thousands)				
Amount Reclassified from AOCI				
Gains (losses) on cash flow hedge:				
Foreign currency forward contracts				
Affected line item in the statement of operations				
Net revenue	\$ 343	\$ 672	\$ 1,019	\$ 1,086
Cost of revenue	1	(6)	(1)	(8)
Research and development	7	(20)	5	(46)
Sales and marketing	5	(98)	(72)	(167)
General and administrative	(1)	(12)	(14)	(23)
Total before tax	355	536	937	842
Tax impact	(75)	(113)	(197)	(177)
Total, net of tax	<u>\$ 280</u>	<u>\$ 423</u>	<u>\$ 740</u>	<u>\$ 665</u>

Note 10. Employee Benefit Plans

The Company grants options and RSUs under the 2016 Incentive Plan (the "2016 Plan"), under which awards may be granted to all employees. Award vesting periods for this plan are generally four years. In May 2020, the Company adopted amendments to the 2016 Plan which increased the number of shares of the Company's common stock that may be issued under the 2016 plan by an additional 2.0 million shares. In addition, any shares subject to restricted stock, restricted stock units, performance units, or performance shares granted on or after May 28, 2020 under the 2016 Plan will be counted against the shares available for issuance as one share for every one share subject to such awards. As of June 28, 2020, approximately 2.7 million shares were reserved for future grants under the 2016 Plan.

Additionally, the Company sponsors an Employee Stock Purchase Plan (the "ESPP"), pursuant to which eligible employees may contribute up to 10% of compensation, subject to certain income limits, to purchase shares of the Company's common stock. The terms of the plan include a look-back feature that enables employees to purchase stock at a price equal to 85% of the lesser of the fair market value at the beginning of the offering period or the purchase date. The duration of each offering period is generally six-months. As of June 28, 2020, approximately 0.5 million shares were available for issuance under the ESPP.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Option Activity

Stock option activity during the six months ended June 28, 2020 was as follows:

	Number of Shares	Weighted Average Exercise Price Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2019	2,188	\$ 26.03
Exercised	(190)	\$ 20.00
Cancelled	(20)	\$ 35.85
Expired	(3)	\$ 22.06
Outstanding as of June 28, 2020	<u>1,975</u>	<u>\$ 26.51</u>

RSU Activity

RSU activity during the six months ended June 28, 2020 was as follows:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2019	1,587	\$ 33.95
Granted	682	\$ 24.98
Vested	(486)	\$ 33.11
Cancelled	(53)	\$ 36.25
Outstanding as of June 28, 2020	<u>1,730</u>	<u>\$ 30.58</u>

Valuation and Expense Information

The Company measures stock-based compensation at the grant date based on the estimated fair value of the award. Estimated compensation cost relating to RSUs is based on the closing fair market value of the Company's common stock on the date of grant. The fair value of options granted and the purchase rights granted under the ESPP is estimated on the date of grant using a Black-Scholes-Merton option valuation model that uses the assumptions noted in the following table. The estimated expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free interest rate of options granted and the purchase rights granted under the ESPP is based on the implied yield currently available on U.S. Treasury securities with a remaining term commensurate with the estimated expected term. Expected volatility of options granted under the 2016 Plan and the purchase rights granted under the ESPP is based on historical volatility over the most recent period commensurate with the estimated expected term.

No options were granted during the three or six months ended June 28, 2020 and June 30, 2019 and no purchase rights were granted during the three months ended June 28, 2020 and June 30, 2019. The following table sets forth the weighted average assumptions used to estimate the fair value of purchase rights granted under the ESPP during the six months ended June 28, 2020 and June 30, 2019:

	Six Months Ended	
	June 28, 2020	June 30, 2019
	ESPP	
Expected life (in years)	0.5	0.5
Risk-free interest rate	1.55%	2.49%
Expected volatility	38.8%	42.6%
Dividend yield	—	—

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table sets forth the stock-based compensation expense resulting from stock options, RSUs and the ESPP included in the Company's unaudited condensed consolidated statements of operations:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
	(In thousands)			
Cost of revenue	\$ 1,501	\$ 755	\$ 2,206	\$ 1,423
Research and development	1,707	1,288	2,741	2,480
Sales and marketing	1,890	2,085	3,669	4,126
General and administrative	4,074	2,611	6,892	5,168
Total	\$ 9,172	\$ 6,739	\$ 15,508	\$ 13,197

As of June 28, 2020, \$5.2 million of unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.6 years. \$44.6 million of unrecognized compensation cost related to unvested RSUs is expected to be recognized over a weighted-average period of 2.4 years.

Note 11. Segment Information

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the Chief Operating Decision Maker ("CODM") of an organization, in order to determine operating and resource allocation decisions. By this definition, the Company has identified its CEO as the CODM. The Company operates and reports in two segments: Connected Home, and SMB:

- **Connected Home:** Focused on consumers and consists of high-performance, dependable and easy-to-use WiFi internet networking solutions such as WiFi mesh systems, routers, 4G/5G mobile products, smart devices such as Meural digital canvasses, and subscription services, offering consumers a range of parental controls and cyber security for their home networks; and
- **SMB:** Focused on small and medium-sized businesses and consists of business networking, wireless LAN, storage, and security solutions that bring enterprise-class functionality to small and medium-sized businesses at an affordable price.

The Company believes that this structure reflects its current operational and financial management, and provides the best structure for the Company to focus on growth opportunities while maintaining financial discipline. The leadership team of each segment is focused on product and service development efforts, both from a product marketing and engineering standpoint, to service the unique needs of their customers.

The results of the reportable segments are derived directly from the Company's management reporting system. The results are based on the Company's method of internal reporting and are not necessarily in conformity with accounting principles generally accepted in the United States. Management measures the performance of each segment based on several metrics, including contribution income. Segment contribution income includes all product line segment revenues less the related cost of sales, research and development and sales and marketing costs. Contribution income is used, in part, to evaluate the performance of, and allocate resources to, each of the segments. Certain operating expenses are not allocated to segments because they are separately managed at the corporate level. These unallocated indirect costs include corporate costs, such as corporate research and development, corporate marketing expense and general and administrative costs, amortization of intangibles, stock-based compensation expense, separation expense, change in fair value of contingent consideration, restructuring and other charges, litigation reserves, net, interest income and other income (expense), net. The CODM does not evaluate operating segments using discrete asset information.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Financial information for each reportable segment and a reconciliation of segment contribution income to income before income taxes is as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
Net Revenue:				
Connected Home	\$ 230,017	\$ 167,495	\$ 394,680	\$ 336,860
SMB	50,035	63,357	115,335	143,074
Total net revenue	<u>\$ 280,052</u>	<u>\$ 230,852</u>	<u>\$ 510,015</u>	<u>\$ 479,934</u>
Contribution Income:				
Connected Home	\$ 36,187	\$ 14,204	\$ 49,774	\$ 33,323
Contribution margin	15.7%	8.5%	12.6%	9.9%
SMB	\$ 4,285	\$ 11,420	\$ 17,852	\$ 34,105
Contribution margin	8.6%	18.0%	15.5%	23.8%
Total segment contribution income	\$ 40,472	\$ 25,624	\$ 67,626	\$ 67,428
Corporate and unallocated costs	(19,489)	(15,576)	(38,451)	(34,708)
Amortization of intangibles ⁽¹⁾	(1,519)	(1,682)	(3,038)	(3,692)
Stock-based compensation expense	(9,172)	(6,739)	(15,508)	(13,197)
Separation expense	—	—	—	(264)
Change in fair value of contingent consideration	(311)	—	(89)	—
Restructuring and other charges	(1,117)	(1,291)	(982)	(1,223)
Litigation reserves, net	3	(10)	(22)	(10)
Interest income	49	782	311	1,483
Other income (expense), net	314	487	(4,272)	828
Income before income taxes	<u>\$ 9,230</u>	<u>\$ 1,595</u>	<u>\$ 5,575</u>	<u>\$ 16,645</u>

⁽¹⁾ Amount excludes amortization expense related to patents within purchased intangibles in cost of revenue.

Operations by Geographic Region

The Company conducts business across three geographic regions: Americas, EMEA, and APAC. Net revenue consists of gross product shipments and service revenue, less allowances for estimated sales returns, price protection, end-user customer rebates and other channel sales incentives deemed to be a reduction of net revenue per the authoritative guidance for revenue recognition, and net changes in deferred revenue. For reporting purposes, revenue is generally attributed to each geographic region based on the location of the customer.

The following table shows net revenue by geography for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
(In thousands)				
United States ("U.S.")	\$ 197,833	\$ 152,785	\$ 352,638	\$ 298,576
Americas (excluding U.S.)	4,413	4,385	7,798	6,623
EMEA	48,359	43,091	90,507	100,054
APAC	29,447	30,591	59,072	74,681
Total net revenue	<u>\$ 280,052</u>	<u>\$ 230,852</u>	<u>\$ 510,015</u>	<u>\$ 479,934</u>

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Long-lived assets by Geographic Region

The Company's long-lived assets, which consist of property and equipment, net and operating lease right-of-use assets, net are located in the following geographic locations:

	As of	
	June 28, 2020	December 31, 2019
	(In thousands)	
United States ("U.S.")	\$ 20,807	\$ 23,137
Americas (excluding U.S.)	3,703	4,036
EMEA	3,932	3,782
Singapore	5,999	—
China	3,944	5,040
APAC (excluding Singapore and China) (1)	8,925	10,605
Total	\$ 47,310	\$ 46,600

(1) No individual country, other than disclosed above, represented more than 10% of the Company's total long-lived assets in the periods presented.

Note 12. Fair Value Measurements

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of June 28, 2020 and December 31, 2019:

	As of June 28, 2020			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Assets:				
Cash equivalents: money-market funds	\$ 22,180	\$ 22,180	\$ —	\$ —
Available-for-sale debt investments: convertible debt(1)	1,326	—	—	1,326
Available-for-sale investments: certificates of deposit(1)	147	—	147	—
Trading securities: mutual funds(1)	4,446	4,446	—	—
Foreign currency forward contracts(2)	273	—	273	—
Total assets measured at fair value	\$ 28,372	\$ 26,626	\$ 420	\$ 1,326
Liabilities:				
Foreign currency forward contracts(3)	\$ 1,336	\$ —	\$ 1,336	\$ —
Contingent consideration(4)	6,016	—	—	6,016
Total liabilities measured at fair value	\$ 7,352	\$ —	\$ 1,336	\$ 6,016

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	As of December 31, 2019			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Assets:				
Cash equivalents: money-market funds	\$ 22,105	\$ 22,105	\$ —	\$ —
Available-for-sale debt investments: convertible debt ⁽¹⁾	1,326	—	—	1,326
Available-for-sale investments: certificates of deposit ⁽¹⁾	149	—	149	—
Trading securities: mutual funds ⁽¹⁾	4,023	4,023	—	—
Foreign currency forward contracts ⁽²⁾	152	—	152	—
Total assets measured at fair value	<u>\$ 27,755</u>	<u>\$ 26,128</u>	<u>\$ 301</u>	<u>\$ 1,326</u>
Liabilities:				
Foreign currency forward contracts ⁽³⁾	\$ 525	\$ —	\$ 525	\$ —
Contingent consideration ⁽⁴⁾	5,928	—	—	5,928
Total liabilities measured at fair value	<u>\$ 6,453</u>	<u>\$ —</u>	<u>\$ 525</u>	<u>\$ 5,928</u>

(1) Included in Short-term investments on the Company's unaudited condensed consolidated balance sheets.

(2) Included in Prepaid expenses and other current assets on the Company's unaudited condensed consolidated balance sheets.

(3) Included in Other accrued liabilities on the Company's unaudited condensed consolidated balance sheets.

(4) Included in Other non-current accrued liabilities on the Company's unaudited condensed consolidated balance sheets. The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with the acquisition of Meural in August 2018 that is contingent upon the achievement of certain technical and service revenue milestones. As of June 28, 2020 and December 31, 2019, there were no material changes in the range of expected outcomes and the fair value of the contingent consideration from the acquisition date.

The Company's investments in cash equivalents and trading securities are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company's available-for-sale marketable investments are classified within Level 2 of the fair value hierarchy because they are valued based on readily available pricing sources for comparable instruments, identical instruments in less active markets, or models using market observable inputs. The Company's foreign currency forward contracts are classified within Level 2 of the fair value hierarchy as they are valued using pricing models that take into account the contract terms as well as currency rates and counterparty credit rates. The Company verifies the reasonableness of these pricing models using observable market data for related inputs into such models. The Company enters into foreign currency forward contracts with only those counterparties that have long-term credit ratings of A-/A3 or higher. The Company's contingent consideration resulting from acquisitions and available-for-sale convertible debt securities, which were issued by a privately held company, are classified within Level 3 of the fair value hierarchy as the valuations typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability. The carrying value of non-financial assets and liabilities measured at fair value in the financial statements on a recurring basis, including accounts receivable and accounts payable, approximate fair value due to their short maturities.

Note 13. Leases

The Company leases office space, cars, distribution centers and equipment under non-cancellable operating lease arrangements with various expiration dates through December 2026. The leases have remaining lease terms of 1 year to 6 years, some of which include options to extend for up to a further 5 years, and some of which include options to terminate prior to completion of the contractual lease term with or without penalties. The Company determines the duration of the lease arrangement giving thought to whether or not it is reasonably certain that the Company will exercise options to extend or terminate the lease arrangement ahead of its contractual term. The leases do not contain any material residual value guarantees.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The components of lease cost were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2020	June 30, 2019	June 28, 2020	June 30, 2019
	(In Thousands)			
Operating lease cost	\$ 2,471	\$ 2,982	\$ 5,351	\$ 5,951
Short-term lease cost (1)	554	504	668	883
Total lease cost (2)	<u>\$ 3,025</u>	<u>\$ 3,486</u>	<u>\$ 6,019</u>	<u>\$ 6,834</u>

(1) Includes variable lease cost, which was immaterial.

(2) Included in cost of revenue, sales and marketing, research and development and general and administration in the Company's unaudited condensed statement of operations.

Supplemental cash flow information related to leases was as follows:

	Six Months Ended	
	June 28, 2020	June 30, 2019
	(In Thousands)	
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows relating to operating leases	\$ 6,257	\$ 6,179
Lease liabilities arising from obtaining right-of-use assets:		
Operating leases	\$ 7,503	\$ 677

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Forward-looking Statements**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended and the Private Securities Litigation Reform Act of 1995. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, the words "believes," "anticipates," "plans," "expects," "intends," "could," "may," "will," and similar expressions are intended to identify forward-looking statements. The forward-looking statements represent NETGEAR, Inc.'s expectations or beliefs concerning future events based on information available at the time such statements were made and include statements regarding: NETGEAR's future operating performance and financial condition, including expectations regarding continued profitability and cash generation; expectations regarding the timing, distribution, sales momentum and market acceptance of recent and anticipated new product introductions that position the Company for growth and market share gain; and expectations regarding NETGEAR's paid subscriber base growth, registered users and registered app users and their effect on NETGEAR's paid subscriber base. These statements are based on management's current expectations and are subject to certain risks and uncertainties, including the following: uncertainty surrounding the duration and impact of the global COVID-19 pandemic; future demand for the Company's products may be lower than anticipated; consumers may choose not to adopt the Company's new product offerings or adopt competing products; product performance may be adversely affected by real world operating conditions; the Company may be unsuccessful or experience delays in manufacturing and distributing its new and existing products; telecommunications service providers may choose to slow their deployment of the Company's products or utilize competing products; the Company may be unable to grow its number of registered users and/or registered app users; the Company may be unable to grow its paid subscriber base; the Company may be unable to collect receivables as they become due; the Company may fail to manage costs, including the cost of developing new products and manufacturing and distribution of its existing offerings; changes in the level of NETGEAR's cash resources and the Company's planned usage of such resources, including potential repurchases of the Company's common stock; changes in the Company's stock price and developments in the business that could increase the Company's cash needs; fluctuations in foreign exchange rates; and the actions and financial health of the Company's customers. Further, certain forward-looking statements are based on assumptions as to future events that may not prove to be accurate. Therefore, our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in "Part II—Item 1A—Risk Factors" and "Liquidity and Capital Resources" below. All forward-looking statements in this document are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements except as required by law. The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes contained in this quarterly report. Unless expressly stated or the context otherwise requires, the terms "we," "our," "us" and "NETGEAR" refer to NETGEAR, Inc. and its subsidiaries.

Business and Executive Overview

We are a global company that delivers innovative, advanced high performance networking technologies and Internet connected products to consumers, businesses, and service providers. Our products are designed to simplify and improve people's lives. Our goal is to enable people to collaborate and connect to a world of information and entertainment. We are dedicated to delivering innovative and advanced connected solutions ranging from mobile and cloud-based services for enhanced control and security, to smart networking products, video over Ethernet for Pro AV applications, easy-to-use WiFi solutions and performance gaming routers to enhance console, online and cloud game play. Our products are built on a variety of technologies such as wireless (WiFi and 4G/5G mobile), Ethernet and powerline, with a focus on reliability and ease-of-use. Additionally, we continually invest in research and development to create new technologies and to capitalize on technological inflection points and trends, such as WiFi 6, 5G and Pro-AV. Our product lines consist of devices that create and extend wired and wireless networks, devices that attach to the network, such as smart digital canvasses as well as services that complement and enhance our product line offerings. These products are available in multiple configurations to address the changing needs of our customers in each geographic region.

We operate and report in two segments: Connected Home, and Small and Medium Business ("SMB"). We believe that this structure reflects our current operational and financial management, and provides the best structure for us to focus on growth opportunities while maintaining financial discipline. The leadership team of each segment is focused on product and service development efforts, both from a product marketing and engineering standpoint, to service the unique needs of their customers. The Connected Home segment is focused on consumers and consists of high-performance, dependable and easy-to-use WiFi internet networking solutions such as WiFi mesh systems, routers, 4G/5G mobile products, smart devices such as Meural digital canvasses, and subscription services, offering consumers a range of parental controls and cyber security for their home networks. The SMB segment is focused on small and medium-sized businesses and consists of business networking, wireless LAN, storage, and security solutions that bring enterprise-class functionality to small and medium-sized businesses at an affordable price. We conduct business across three geographic regions: Americas; Europe, Middle-East and Africa ("EMEA") and Asia Pacific ("APAC").

The markets in which our segments operate are intensely competitive and subject to rapid technological change. We believe that the principal competitive factors in the consumer and small and medium business markets for networking products include product breadth, price points, size and scope of the sales channel, brand name, timeliness of new product introductions, product availability, performance, features, functionality and reliability, ease-of-installation, maintenance and use, security, and customer service and support. To remain competitive, we believe we must continue to aggressively invest resources in developing new products and subscription services, enhancing our current products, expanding our channels including our direct to consumer capabilities, increasing engagement with our customers and maintaining customer satisfaction worldwide. Our investments reflect our enhanced focus on cybersecurity relating to our products and systems, as the threat of cyber-attacks and exploitation of potential security vulnerabilities in our industry is on the rise and is increasingly a significant consumer concern.

We sell our products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers ("DMRs"), value-added resellers ("VARs"), broadband service providers and our webstore at www.netgear.com for the U.S. market. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Costco, Wal-Mart, Staples, Office Depot, Target, FNAC (Europe), MediaMarkt (Europe), Darty (France), JB HiFi (Australia), Elkjop (Norway) and Sunning and Guomei (China). Online retailers include Amazon.com worldwide, Newegg.com (U.S.), JD.com and Alibaba (China), as well as Coolblue.com (Netherlands). Our DMRs include CDW Corporation, Insight Corporation and PC Connection in domestic markets. Our main wholesale distributors include Ingram Micro, D&H, Tech Data, Exertis (U.K.) and Synnex. In addition, we also sell our products through broadband service providers, such as multiple system operators ("MSOs"), xDSL, mobile, and other broadband technology operators domestically and internationally. Some of these retailers and broadband service providers purchase directly from us, while others are fulfilled through wholesale distributors around the world. A substantial portion of our net revenue is derived from a limited number of wholesale distributors, service providers and retailers. We expect this trend will continue in the foreseeable future.

During the three months ended June 28, 2020, our net revenue and income from operations increased by \$49.2 million and \$8.5 million, compared to the prior year period, respectively. The growth in net revenue was mainly driven by increased demand for our Connected Home products in response to increased work and schooling from home mandates resulting from the COVID-19 pandemic. The increase was partially offset by lower net revenue from SMB products resulting from disruptions to the VAR channel experienced since the onset of the pandemic. Gross margin increased to 29.0% from 28.3% in the prior year period, primarily due to lower spending on channel promotional activities deemed to be a reduction of net revenue. The increase in gross margin was partially offset by an increase of \$7.3 million in operating expenses, primarily driven by higher expenditures in general and administrative of \$5.0 million and research and development of \$2.3 million.

On a geographic basis, net revenue increased in Americas and EMEA and decreased in APAC in the three months ended June 28, 2020 as compared to the prior year period. The increase in Americas was mainly attributable to home wireless and mobile products, partially offset by lower net revenue of our switch products. The increase in EMEA was primarily due to higher net revenue of our mobile and home wireless products, partially offset by lower net revenue of our switch products. The decreases in APAC net revenue were primarily due to lower net revenue of broadband modem and gateway and switch products, partially offset by higher net revenue of home wireless products.

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared the COVID-19 outbreak a pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and work force participation and created significant volatility and disruption in financial markets. The onset of the COVID-19 pandemic initially impacted our supply chain partners, lowering finished good receipts by approximately 30% compared to planned receipts in the first quarter of 2020. At the same time, we saw a significant increase in airfreight rates to transport supply as a result of reduced capacity by carriers. In March 2020, the spread of the pandemic to the U.S. and mainland Europe resulted in a surge in demand for Connected Home products as consumers responded to work from home and shelter-in-place measures. This surge in demand continued throughout the second quarter of 2020 and contributed to Connected Home net revenue growth of 39.7% and 37.3%, compared to the first quarter of 2020 and the second quarter of 2019, respectively. By contrast, demand for SMB products began to weaken as businesses faced closures and reacted to the uncertainty caused by the pandemic. Weakness in SMB product demand continued throughout the second quarter of 2020 contributing to net revenue declining by 23.4% and 21.0%, compared to the first quarter of 2020 and the second quarter of 2019, respectively. Commencing the middle of March 2020, the majority of our major offices worldwide had enacted shelter-in-place measures, with employees being mandated to work from home. We enabled our crisis management team and put in place travel restrictions initially to/from Mainland China and Hong Kong early in the first quarter of 2020, and subsequently restricted all international travel, while limiting domestic travel to essential travel only in order to protect the health and well-being of our workforce and prevent the spread of the virus. A number of our large customers are designated as essential service providers allowing us to fulfill demand without restrictions. A number of our large retail trading partners have intermittently closed stores and fulfilled customer demand through a combination of curbside pick-up and online sales. Our wholesale distributors in certain regions, such as Italy, have been subject to disruption and forced to operate on a reduced basis. In addition, we have donated hundreds of mobile hotspots to various San Francisco Bay Area school districts in the U.S. for student use as part of our response to helping our local community cope with the effects of the pandemic.

Given the business shutdown and shelter-in-place/stay-at-home orders in various parts of the world, and the uncertainty of how and when such lockdowns will be eased, in April 2020 we withdrew our prior targets of net revenue growth and gross margin for the full year of 2020 as disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. Throughout the second quarter of 2020, we continued to see off-and-on lockdowns in parts of the world, especially in the U.S. as infection rates stabilized or increased. The COVID-19 pandemic has brought about a considerable shift in our business while increasing uncertainty. We are seeing a surge in demand for our Connected Home products in both service provider and non-service provider channels. We expect the shift to remote working to increase relative to the experience pre-pandemic, increasing the demand for high performance and dependable WiFi networks. Looking forward, we expect non-service provider net revenue in the third quarter of 2020 to grow at similar rates to the second quarter of 2020 compared to the prior year period. In addition, we expect service provider net revenue to grow 50% in the second half of 2020 compared to first half of 2020. We expect SMB net revenue will increase above the second quarter of 2020 if the global economy begins to recover and regions affected by the pandemic start to reopen, though the timing of such recovery and reopening is unknown at present. In the next two quarters, we expect limitations to supply capacity, constrained by material availability, factory uptime and freight capacity. We expect to incur higher than normal freight costs in order to meet demand. Further, while we currently expect supply chain partners to be able to operate at normal capacity in the second half of 2020, any further disruption brought about by COVID-19 to supply chain partners, production schedules or freight carriers could have a significant negative impact on gross and operating margin performance.

The extent of the impact of the COVID-19 pandemic on our ongoing operational and financial performance, including our ability to execute our business strategies and initiatives in the expected time frame, will depend on future developments, including the duration and spread of the pandemic and related disruptions to channel partners and restrictions on travel and transport, all of which are uncertain and cannot be predicted. The impact of the pandemic on our employees, their health and well-being and our ability to continue to instill our company culture and maintain productivity is uncertain and cannot be predicted. With the increase in work from home and distance learning mandates since the commencement of the pandemic, we believe we will continue to see a move to greater participation by companies and employees in remote working and learning increasing the demand for high performance, dependable WiFi networks. Refer

to Item 1A, Risk Factors of Part II of this Quarterly Report on Form 10-Q for various risks and uncertainties associated with the COVID-19 pandemic.

Results of Operations

The following table sets forth the unaudited condensed consolidated statements of operations for the three and six months ended June 28, 2020, with the comparable reporting periods in the preceding year.

	Three Months Ended				Six Months Ended			
	June 28, 2020		June 30, 2019		June 28, 2020		June 30, 2019	
	(In thousands, except percentage data)							
Net revenue	\$ 280,052	100.0%	\$ 230,852	100.0%	\$ 510,015	100.0%	\$ 479,934	100.0%
Cost of revenue	198,751	71.0%	165,407	71.7%	362,473	71.1%	332,481	69.3%
Gross profit	81,301	29.0%	65,445	28.3%	147,542	28.9%	147,453	30.7%
Operating expenses:								
Research and development	21,144	7.6%	18,814	8.1%	40,883	8.0%	37,646	7.8%
Sales and marketing	34,384	12.2%	34,541	15.0%	67,415	13.2%	70,396	14.6%
General and administrative	15,481	5.5%	10,463	4.5%	28,615	5.6%	23,580	4.9%
Other operating expenses, net	1,425	0.5%	1,301	0.6%	1,093	0.2%	1,497	0.4%
Total operating expenses	72,434	25.8%	65,119	28.2%	138,006	27.0%	133,119	27.7%
Income from operations	8,867	3.2%	326	0.1%	9,536	1.9%	14,334	3.0%
Interest income	49	0.0%	782	0.4%	311	0.0%	1,483	0.3%
Other income (expense), net	314	0.1%	487	0.2%	(4,272)	(0.8)%	828	0.2%
Income before income taxes	9,230	3.3%	1,595	0.7%	5,575	1.1%	16,645	3.5%
Provision for income taxes	3,247	1.2%	756	0.3%	3,765	0.7%	2,963	0.6%
Net income	\$ 5,983	2.1%	\$ 839	0.4%	\$ 1,810	0.4%	\$ 13,682	2.9%

Net Revenue by Geographic Region

Our net revenue consists of gross product shipments and service revenue, less allowances for estimated sales returns, price protection, end-user customer rebates and other channel sales incentives deemed to be a reduction of net revenue per the authoritative guidance for revenue recognition, and net changes in deferred revenue.

We conduct business across three geographic regions: Americas, EMEA and APAC. For reporting purposes, revenue is generally attributed to each geographic region based upon the location of the customer.

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Americas	\$ 202,246	28.7%	\$ 157,170	\$ 360,436	18.1%	\$ 305,199
Percentage of net revenue	72.2%		68.0%	70.7%		63.6%
EMEA	\$ 48,359	12.2%	\$ 43,091	\$ 90,507	(9.5)%	\$ 100,054
Percentage of net revenue	17.3%		18.7%	17.7%		20.8%
APAC	\$ 29,447	(3.7)%	\$ 30,591	\$ 59,072	(20.9)%	\$ 74,681
Percentage of net revenue	10.5%		13.3%	11.6%		15.6%
Total net revenue	\$ 280,052	21.3%	\$ 230,852	\$ 510,015	6.3%	\$ 479,934

Americas

Net revenue in Americas increased in the three and six months ended June 28, 2020, compared to the prior year periods, largely due to increased demand for our Connected Home products in response to work and schooling from home mandates resulting from the COVID-19 pandemic. The surge in demand that began in March continued throughout the entire second quarter and resulted in strong growth in both the non-service provider and service provider channels. The increase was partially offset by lower SMB net revenue as the pandemic negatively impacted demand. Connected Home net revenue increased by 36.6% and 25.9% in the three and six months ended June 28, 2020, respectively, compared to the prior year periods. We experienced strong consumer demand for our home wireless products, especially WiFi mesh systems, WiFi 6 routers and extenders. Growth in service provider channels was driven by mobile products. SMB net revenue decreased by 12.0% and 14.0% in the three and six months ended June 28, 2020, respectively, compared to the prior year periods, primarily due to lower net revenue of our switch products.

EMEA

Net revenue in EMEA increased in the three months ended June 28, 2020, but decreased in the six months ended June 28, 2020, compared to the prior year periods. Connected Home net revenue increased by 78.0% and 13.8% in the three and six months ended June 28, 2020, respectively, compared to the prior year periods, mainly driven by higher net revenue from mobile and home wireless products. SMB net revenue declined by 32.9% and 27.3% in the three and six months ended June 28, 2020, respectively, compared to the prior year periods, mainly attributable to lower net revenue of switch products. Demand for SMB products weakened at the onset of the pandemic as businesses were forced to close to comply with shelter in place measures or delayed infrastructure investments in response to the worsening economic climate.

APAC

The decrease in APAC net revenue for the three and six months ended June 28, 2020 was mainly driven by lower net revenue of \$5.1 million and \$15.5 million, respectively, from our service provider customers, compared to the prior year periods. The decline was largely driven by our service provider customers in Australia where we experienced declines in order volumes in the six months ended June 28, 2020, compared to the prior year period. From a product perspective, the decrease in APAC net revenue was primarily due to lower net revenue of broadband modem and gateway and switch products, partially offset by higher net revenue of home wireless products.

Cost of Revenue and Gross Margin

Cost of revenue consists primarily of the following: the cost of finished products from our third party manufacturers; overhead costs, including purchasing, product planning, inventory control, warehousing and distribution logistics; third-party software licensing fees; inbound freight; import duties/tariffs; warranty costs associated with returned goods; write-downs for excess and obsolete inventory; amortization of certain acquired intangibles and capitalized software development costs; and costs attributable to the provision of service offerings.

We outsource our manufacturing, warehousing and distribution logistics. We believe this outsourcing strategy allows us to better manage our product costs and gross margin. Our gross margin can be affected by a number of factors, including fluctuation in foreign exchange rates, sales returns, changes in average selling prices, end-user customer rebates and other channel sales incentives, changes in our cost of goods sold due to fluctuations in prices paid for components, net of vendor rebates, warranty and overhead costs, inbound freight and duty/tariffs, conversion costs, charges for excess or obsolete inventory, amortization of acquired intangibles and capitalized software development costs. The following table presents costs of revenue and gross margin, for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Cost of revenue	\$ 198,751	20.2%	\$ 165,407	\$ 362,473	9.0%	\$ 332,481
Gross margin percentage	29.0%		28.3%	28.9%		30.7%

Cost of revenue increased for the three and six months ended June 28, 2020 compared to the prior year periods, mainly due to higher net revenue.

Gross margin increased for the three months ended June 28, 2020 compared to the prior year period, primarily due to lower provisions for channel promotional activities deemed to be a reduction of net revenue, partially offset by higher air freight expense and provisions for warranty as a proportion of net revenue. Gross margin for the three and six months ended June 28, 2020 compared to the prior year periods was adversely impacted by product mix, as SMB products, which typically carry a higher gross margin than Connected Home products, comprised a lower proportion of net revenue. In addition, during the six months ended June 28, 2020, provisions for warranty and air freight expenses as a proportion of net revenue increased, partially offset by lower provisions for channel promotional activities as a proportion of net revenue, compared to the prior year period.

In the first fiscal quarter of 2020, our supply chain partners operated at reduced capacity due to the COVID-19 pandemic, resulting in lower purchases and consequently higher overhead costs associated with such inventory sold during the three months ended June 28, 2020. Additionally, air freight carriers have been operating at reduced capacity since the onset of the pandemic, resulting in significantly increased rates associated with transporting supply. Our supply chain supporting our Connected Home business has been and could continue to be disrupted by outbreaks of Covid-19 in our suppliers' factories and warehouses. If such disruptions become widespread, they could significantly hamper our ability to fulfill the heightened demand for our Connected Home products. Forecasting gross margin percentages is difficult, and there are a number of risks related to our ability to maintain or improve our current gross margin levels. Our cost of revenue as a percentage of net revenue can vary significantly based upon factors such as: uncertainties surrounding revenue levels, including future pricing and/or potential discounts as a result of the economy or in response to the strengthening of the U.S. dollar in our international markets, and related production level variances; import customs duties and imposed tariffs; competition; changes in technology; changes in product mix; variability of stock-based compensation costs; royalties to third parties; fluctuations in freight costs; manufacturing and purchase price variances; changes in prices on commodity components; warranty costs; and the timing of sales. We expect that revenue derived from paid subscription service plans will continue to increase in the future, which may have a positive impact on our gross margin. From time to time, however, we may experience fluctuations in our gross margin as a result of the factors discussed above.

Operating Expenses

Research and Development

Research and development expense consists primarily of personnel expenses, payments to suppliers for design services, safety and regulatory testing, product certification expenditures to qualify our products for sale into specific markets, prototypes, IT and facility allocations, and other consulting fees. Research and development expenses are recognized as they are incurred. Our research and development organization is focused on enhancing our ability to introduce innovative and easy-to-use products and services. The following table presents research and development expense, for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Research and development	\$ 21,144	12.4%	\$ 18,814	\$ 40,883	8.6%	\$ 37,646

Research and development expense increased for the three and six months ended June 28, 2020, mainly due to increases in engineering projects and outside professional services of \$2.2 million and \$4.0 million, respectively, compared to the prior year periods driven primarily by higher spending on development of initiatives to support growth. Research and development headcount was 277 as of June 28, 2020 and 273 as of June 30, 2019.

We believe that innovation and technological leadership is critical to our future success, and we are committed to continuing a significant level of research and development to develop new technologies, products and services to combat competitive pressures. We continue to invest in research and development to grow our cloud platform capabilities, and connected home products portfolio including services and mobile applications, expand our Pro-AV, web-managed, app-managed, 10Gig and PoE switch products, and develop innovative WiFi and Advanced 4G/5G mobile and 5G coverage solutions. For the third fiscal quarter of 2020, we expect research and development expenses to increase in absolute dollars compared with the second fiscal quarter of 2020. Research and development remains critical to our future success and we expect to continue to allocate resources to help accelerate growth in key strategic areas such as the continued development of our WiFi 6 product portfolio as well as service offerings. Research and development expenses will fluctuate depending on the timing and number of development activities in any given quarter and could vary significantly as a percentage of net revenue, depending on actual revenues achieved in any given quarter.

Sales and Marketing

Sales and marketing expense consists primarily of advertising, trade shows, corporate communications and other marketing expenses, product marketing expenses, outbound freight costs, amortization of certain intangibles, personnel expenses for sales and marketing staff, technical support expenses, and IT and facility allocations. The following table presents sales and marketing expense, for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Sales and marketing	\$ 34,384	(0.5)%	\$ 34,541	\$ 67,415	(4.2)%	\$ 70,396

Sales and marketing expense decreased for the three and six months ended June 28, 2020, compared to the prior year periods, primarily due to decreases in marketing expenditures of \$1.8 million and \$3.1 million, mainly resulting from lower brand marketing campaigns, and personnel-related expenditures of \$0.3 million and \$1.3 million, partially offset by increases in freight costs of \$2.0 million and \$2.8 million, respectively. The reduction in personnel-related expenditures was net of increases of \$1.5 million and \$1.6 million in variable compensation as a result of the increased sales in the first half of 2020. Sales and Marketing headcount decreased from 294 as of June 30, 2019 to 262 as of June 28, 2020. The reduction in headcount was primarily associated with restructuring activities during the latter part of fiscal 2019 as we reduced headcount in China and a number of other countries in APAC and EMEA. In addition, we closed offices in some of the affected jurisdictions.

We expect our sales and marketing expense to increase in absolute dollars but to decrease as a portion of the net revenue in the third fiscal quarter of 2020 compared to the second fiscal quarter of 2020. Expenses may fluctuate depending on revenue levels achieved as certain expenses, such as commissions, are determined based upon the revenues achieved. Forecasting sales and marketing expenses is highly dependent on expected revenue levels and could vary significantly depending on actual revenues achieved in any given quarter. Marketing expenses will also fluctuate depending upon the timing, extent and nature of marketing programs. Marketing expenditure committed with a customer is generally recorded as a reduction of net revenue per authoritative guidance.

General and Administrative

General and administrative expense consists of salaries and related expenses for executives, finance and accounting, human resources, information technology, professional fees, including legal costs associated with defending claims against us, allowance for doubtful accounts, IT and facility allocations, and other general corporate expenses. The following table presents general and administrative expense, for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
General and administrative	\$ 15,481	48.0%	\$ 10,463	\$ 28,615	21.4%	\$ 23,580

General and administrative expense increased for the three and six months ended June 28, 2020, primarily due to increases in personnel-related expenditures of \$2.8 million and \$3.1 million, and other general corporate expenses of \$2.2 million and \$2.3 million, respectively, compared to the prior year periods. The increase in personnel-related expenditures in both periods was mainly due to increases in stock-based compensation, variable compensation and other employee costs. The increase in other general corporate expenses in both periods was primarily the result of the prior year period benefitting from a refund of value-added taxes previously incurred whereas there was no such refund in the current year period. General and administrative headcount was 143 as of June 28, 2020 and 147 as of June 30, 2019.

We expect our general and administrative expenses as a proportion of net revenue in the third fiscal quarter of 2020 to decrease compared with the second fiscal quarter of 2020. General and administrative expenses could fluctuate depending on a number of factors, including the level and timing of expenditures associated with litigation defense costs in connection with the litigation matters described in *Note 8, Commitments and Contingencies*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q. Future general and administrative expense increases or decreases in absolute dollars are difficult to predict due to the lack of visibility of certain costs, including legal costs associated with defending claims against us, as well as legal costs associated with asserting and enforcing our intellectual property portfolio and other factors.

Other operating expenses, net

Other operating expenses, net consists of restructuring and other charges, litigation reserves, net, change in the fair value of contingent consideration and separation expense.

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Other operating expenses, net	\$ 1,425	9.5%	\$ 1,301	\$ 1,093	(27.0)%	\$ 1,497

The change in Other operating expenses, net in the three and six months ended June 28, 2020 was not material compared to the prior year periods.

Interest Income and Other Income (Expense), Net

Interest income represents amounts earned on our cash, cash equivalents and short-term investments. Other income (expense), net primarily represents gains and losses on transactions denominated in foreign currencies, gains and losses on investments, and other non-operating income and expenses. The following table presents interest income and other income (expense), net for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Interest income	\$ 49	(93.7)%	\$ 782	\$ 311	(79.0)%	\$ 1,483
Other income (expense), net	314	(35.5)%	487	(4,272)	**	828
Total	<u>\$ 363</u>	<u>(71.4)%</u>	<u>\$ 1,269</u>	<u>\$ (3,961)</u>	<u>**</u>	<u>\$ 2,311</u>

** Percentage change not meaningful.

Interest income decreased for the three and six months ended June 28, 2020, mainly due to lower short term invested balances and lower yields on invested funds.

The change in other income (expense), net in the three months ended June 28, 2020 was not material, compared to the prior year period. The change in the six months ended June 28, 2020, compared to the prior year period, was primarily due to \$4.5 million of impairment charges in the first quarter of 2020 brought about by triggering events impacting the valuation of a number of our privately held long-term investments, partially due to the onset of the COVID-19 pandemic. Our foreign currency hedging program effectively reduced volatility associated with hedged currency exchange rate movements during the three and six months ended June 28, 2020. For a detailed discussion of our hedging program and related foreign currency contracts, refer to [Note 5. Derivative Financial Instruments](#), in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Provision for Income Taxes

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(In thousands, except percentage data)						
Provision for income taxes	\$ 3,247	329.5%	\$ 756	\$ 3,765	27.1%	\$ 2,963
Effective tax rate	35.2%		47.4%	67.5%		17.8%

The increase in tax expense for the three months ended June 28, 2020, compared to the prior year period, was due primarily to higher pre-tax earnings coupled with the negative impact of limitations on current and future stock-based compensation deductions for certain executive officers under IRC section 162(m). The increase in tax expense for the six months ended in June 28, 2020, compared to the prior year period, results primarily from an increase in valuation allowance on deferred tax assets from investment impairments where the deferred tax benefit is not considered more likely than not, as well as the impact of limitations on current and future stock-based compensation deductions for certain executive officers under IRC section 162(m). These increases to tax expense were partially offset by favorable tax benefits recorded in the six months ended June 30, 2019 related to settlement of tax audits.

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Our future foreign tax rate could be affected by changes in the composition in earnings in countries with tax rates differing from the U.S. federal rate. We have been notified by the Internal Revenue Service ("IRS") in a letter dated July 13, 2020 that they will conduct an examination of the fiscal year ended December 31, 2018. In addition to the recent notification of audit by the IRS, we are under examination in various other U.S. and foreign jurisdictions.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”) was signed into law in response to the COVID-19 pandemic. The CARES Act, among other provisions, includes provisions related to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating losses carryback periods, alternative minimum tax credit refunds, modification to net interest expense deduction limitation, and technical amendments to tax depreciation methods for qualified improvement property placed in service after December 31, 2017. The Company does not expect these provisions of The CARES Act to have a material impact to income taxes and liquidity.

Segment Information

A description of our products and services, as well as segment financial data, for each segment and a reconciliation of segment contribution income to income before income taxes can be found in [Note 11. Segment Information](#), in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Connected Home

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(in thousands, except percentage data)						
Net revenue	\$ 230,017	37.3%	\$ 167,495	\$ 394,680	17.2%	\$ 336,860
Percentage of net revenue	82.1%		72.6%	77.4%		70.2%
Contribution income	\$ 36,187	154.8%	\$ 14,204	\$ 49,774	49.4%	\$ 33,323
Contribution margin	15.7%		8.5%	12.6%		9.9%

The increase in Connected Home segment net revenue in the three and six months ended June 28, 2020, compared to prior year periods, was mainly driven by increased demand in response to work from home and schooling from home mandates. Connected Home benefitted from a surge in demand from consumer channels upon commencement of the pandemic, with end users seeking to upgrade and enhance their WiFi networks resulting in net revenue increasing by 32.2% and 18.6% in the three and six months ended June 28, 2020 compared to the prior year periods. The increase was driven by increased demand for home wireless products, mainly WiFi mesh systems, WiFi 6 routers and extenders. In addition, Connected Home experienced significant increases in demand from service provider customers for mobile products resulting in net revenue increasing by 64.1% and 11.2% in the three and six months to June 28, 2020 compared to the prior year periods. The increased service provider demand for mobile products offset declines in broadband modems and gateways compared to the prior year comparative periods. Geographically, the increase in demand from consumer channels was experienced across all regions while the increase in service provider was attributable to U.S. and EMEA.

Contribution income increased in the three and six months ended June 28, 2020, compared to the prior year periods, primarily due to higher net revenue, higher gross margin attainment and lower operating expenses as a proportion of net revenue. The improvement in gross margin was due to a combination of increased product margin and lower promotional marketing activities deemed to be a reduction of net revenue, partially offset by higher provisions for warranty and air freight expense.

SMB

	Three Months Ended			Six Months Ended		
	June 28, 2020	% Change	June 30, 2019	June 28, 2020	% Change	June 30, 2019
(in thousands, except percentage data)						
Net revenue	\$ 50,035	(21.0)%	\$ 63,357	\$ 115,335	(19.4)%	\$ 143,074
Percentage of net revenue	17.9%		27.4%	22.6%		29.8%
Contribution income	\$ 4,285	(62.5)%	\$ 11,420	\$ 17,852	(47.7)%	\$ 34,105
Contribution margin	8.6%		18.0%	15.5%		23.8%

SMB segment net revenue decreased for the three and six months ended June 28, 2020, compared to the prior year periods, primarily due to a weakening of demand occurring upon commencement of the pandemic as businesses were forced to close to comply with shelter-in-place measures or delayed infrastructure investments in response to the worsening economic climate. The decline in net revenue was mainly attributable to lower net revenue from our switch and network storage products in the three and six months ended June 28, 2020, compared to the prior year periods. Geographically, net revenue declined across all three regions in the three and six months ended June 28, 2020, compared to the prior year periods.

Contribution income decreased for the three and six months ended June 28, 2020, compared to the prior year periods, primarily as a result of lower net revenue, lower gross margin attainment and higher operating expenses as a proportion of net revenue. The lower gross margin was due to a combination of lower net revenue and channel and promotional activities increasing dis-proportionately to net revenue compared to the prior year comparative periods.

Liquidity and Capital Resources

Our principal sources of liquidity are cash, cash equivalents, short-term investments and cash generated from operations. As of June 28, 2020, we had cash, cash equivalents and short-term investment of \$258.6 million, an increase of \$62.9 million from \$195.7 million as of December 31, 2019.

As of June 28, 2020, approximately 35% of our cash and cash equivalents and short-term investments were outside of the U.S. The cash and cash equivalents and short-term investments balances outside of the U.S. are subject to fluctuation based on the settlement of intercompany balances. As we repatriate these funds in accordance with our designation of funds not permanently reinvested outside of the U.S., we will be required to pay income taxes in certain U.S. states and applicable foreign withholding taxes during the period when such repatriation occurs. We have recorded deferred taxes for the tax effect of repatriating the funds to the U.S.

The following table presents our cash flows for the periods presented.

	Six Months Ended	
	June 28, 2020	June 30, 2019
	(In thousands)	
Cash provided by (used in) operating activities	\$ 92,170	\$ (9,927)
Cash provided by (used in) investing activities	(9,894)	55,877
Cash used in financing activities	(19,851)	(32,386)
Net cash increase	<u>\$ 62,425</u>	<u>\$ 13,564</u>

Operating activities

Net cash provided by operating activities was \$92.2 million for the six months ended June 28, 2020 compared to \$9.9 million of cash used in the prior year period, primarily due to favorable working capital movements. The higher net cash inflow from working capital was mainly driven by lower inventory holding and lower payments to suppliers, partially offset by higher accounts receivable.

Our DSO decreased to 90 days as of June 28, 2020 as compared to 102 days as of December 31, 2019. The improvement was as result of timing of shipments and more favorable channel revenue mix. Our accounts payable decreased from \$80.5 million as of December 31, 2019 to \$76.1 million as of June 28, 2020 as inventory receipts from trade suppliers were lower in the six months ended June 28, 2020 compared to the six months ended December 31, 2019. Inventory decreased from \$235.5 million as of December 31, 2019 to \$150.6 million as of June 28, 2020. The decline in inventory was due to a combination of higher net revenue and lower inventory receipts from suppliers in the six months ended June 28, 2020, compared to the prior year period. Ending inventory turns were 5.3 in the three months ended June 28, 2020, up from 3.1 turns in the three months ended December 31, 2019.

Investing activities

Net cash used in investing activities was \$9.9 million in the six months ended June 28, 2020 compared to \$55.9 million of cash provided in the prior year period. During the six months ended June 28, 2020, investing cash outflows mainly related to purchases of long-term investments and property and equipment. In the prior year period, \$70.6 million of cash received from maturities of short-term investments more than offset the cash outflows on purchases of long-term investments and property and equipment.

Financing activities

Net cash used in financing activities was \$19.9 million in the six months ended June 28, 2020 compared to \$32.4 million in the prior year period, primarily due to lower stock repurchase activity and lower payments relating to restricted stock unit tax withholdings.

From time to time, our Board of Directors has authorized programs under which we may repurchase shares of our common stock. Under the authorizations, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and the price of our common stock. As of June 28, 2020, 2.7 million shares remained authorized for repurchase under the repurchase program. We repurchased and retired, reported based on trade date, approximately 0.9 million and 1.0 million shares of common stock at a cost of approximately \$22.5 million and \$32.0 million during the six months ended June 28, 2020 and June 30, 2019, respectively. We also repurchased and retired, reported based on trade date, approximately 149,000 and 168,000 shares of common stock, at a cost of approximately \$3.6 million and \$5.7 million during the six months ended June 28, 2020 and June 30, 2019, respectively, to administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs. For a detailed discussion of our common stock repurchases, refer to [Note 9. Stockholders' Equity](#), in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q. We recognize the importance of maintaining a strong cash position in a time of uncertainty and intend to balance our practice of repurchasing shares with our desire to maintain a strong balance sheet.

We enter into foreign currency forward-exchange contracts, which typically mature within six months, to hedge a portion of our exposure to foreign currency fluctuations of foreign currency-denominated revenue, costs of revenue, certain operating expenses, receivables, payables, and cash balances. We record on the consolidated balance sheets at each reporting period the fair value of our forward-exchange contracts and record any fair value adjustments in our consolidated statements of operations and on our consolidated balance sheets. Gains and losses associated with currency rate changes on hedge contracts that are non-designated under the authoritative guidance for derivatives and hedging are recorded within other income (expense), net, offsetting foreign exchange gains and losses on our monetary assets and liabilities. Gains and losses associated with currency rate changes on hedge contracts that are designated cash flow hedges under the authoritative guidance for derivatives and hedging are recorded within accumulated other comprehensive income until the related revenue, costs of revenue, or expenses are recognized.

Based on our current plans and market conditions, we believe that our existing cash, cash equivalents and short-term investments, together with cash generated from operations, will be sufficient to satisfy our anticipated cash requirements for at least the next twelve months. However, we may require or desire additional funds to support our operating expenses and capital requirements or for other purposes, such as acquisitions, and may seek to raise such additional funds through public or private equity financing or from other sources. We cannot assure you that additional financing will be available at all or that, if available, such financing would be obtainable on terms favorable to us and would not be dilutive. Our future liquidity and cash requirements will depend on numerous factors, including the introduction of new products and potential acquisitions of related businesses or technology.

Contractual Obligations

Except as follows, there were no material changes outside of the ordinary course of business in our contractual obligations as of June 28, 2020, from those as of December 31, 2019 disclosed in Part II, Item 7, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

We have entered into various master purchase agreements for inventory with suppliers. Generally, under these agreements, 50% of orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within

30 days prior to the expected shipment date. For those orders not governed by master purchase agreements, the commitments are governed by the commercial terms on our purchase orders subject to acknowledgment from our suppliers. As of June 28, 2020, we had approximately \$124.4 million in non-cancelable purchase commitments with suppliers. We establish a loss liability for all products we do not expect to sell for which we have committed purchases from suppliers. Such loss liability was included in Other accrued liabilities on our unaudited condensed consolidated balance sheets. From time to time our suppliers procure unique complex components on our behalf. If these components do not meet specified technical criteria or are defective, we should not be obligated to purchase the materials. However, disputes may arise as a result and significant resources may be spent resolving such disputes.

We lease office space, cars, distribution centers and equipment under non-cancelable operating leases with various expiration dates through December 2026. As of June 28, 2020, we had approximately \$40.2 million in non-cancelable operating lease commitment. The terms of certain of our facility leases provide for rental payments on a graduated scale. Lease expense is recognized on a straight-line basis over the lease term. Refer to [Note 13. Leases](#), in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for details on our leases. The amounts presented are consistent with contractual terms and are not expected to differ significantly, unless a substantial change in our headcount needs requires us to exit an office facility early or expand our occupied space.

Off-Balance Sheet Arrangements

As of June 28, 2020, we did not have any off-balance-sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements, we make assumptions, judgments and estimates that can have a significant impact on our revenue, operating income and net income, as well as on the value of certain assets and liabilities on our condensed consolidated balance sheets. We base these estimates on historical and anticipated results, trends and various other assumptions that we believe are reasonable under the circumstances. As of the date of issuance of these condensed consolidated financial statements, we are not aware of any specific event or circumstance that would require us to update our estimates, judgments or revise the carrying value of our assets or liabilities. These estimates may change, as new events occur and additional information is obtained, and are recognized in the condensed consolidated financial statements as soon as they become known. Actual results could differ materially from those estimates under different assumptions and conditions.

For a complete description of what we believe to be the critical accounting policies and estimates used in the preparation of our Unaudited Condensed Consolidated Financial Statements, refer to our Annual Report on Form 10-K for the year ended December 31, 2019. Refer to [Note 1. The Company and Basis of Presentation](#) and [Note 2. Summary of Significant Accounting Policies](#), in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for the risks and uncertainties related to the COVID-19 pandemic and the updated accounting policy on credit losses upon the adoption of ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326)" as of January 1, 2020, respectively.

Recent Accounting Pronouncements

See [Note 2. Summary of Significant Accounting Policies](#), in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Report on Form 10-Q, for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on financial condition and results of operations, which are hereby incorporated by reference.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

During the six months ended June 28, 2020, there were no material changes to our market risk disclosures as set forth in Part II Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2019.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of our management (including our Chief Executive Officer and Chief Financial Officer), our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), were effective as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting. It should be noted that any system of controls, however well designed and operated, can provide only reasonable assurance, and not absolute assurance, that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals in all future circumstances. We have not experienced any material impact to our internal controls over financial reporting despite the fact that most of our employees are working remotely due to the COVID-19 pandemic. We are continually monitoring and assessing the COVID-19 situation on our internal controls to minimize the impact on their design and operating effectiveness.

PART II: OTHER INFORMATION

Item 1. *Legal Proceedings*

The information set forth under [Note 8. Commitments and Contingencies](#), in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Item 1A. *Risk Factors*

Investing in our common stock involves a high degree of risk. The risks described below are not exhaustive of the risks that might affect our business. Other risks, including those we currently deem immaterial, may also impact our business. Any of the following risks could materially adversely affect our business operations, results of operations and financial condition and could result in a significant decline in our stock price. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in this section. This section should be read in conjunction with the unaudited condensed consolidated financial statements and accompanying notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Quarterly Report on Form 10-Q.

We have marked with an asterisk () those risks described below that reflect substantive changes from the risks described under Part I, Item 1A “Risk Factors” included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 18, 2020.*

***The COVID-19 pandemic could materially adversely affect our financial condition and results of operations.**

The novel strain of the coronavirus identified in late 2019 (COVID-19) has spread as a global pandemic throughout many parts of Asia, Europe, the Middle East, and North America and has resulted in authorities imposing, and businesses and individuals implementing, numerous unprecedented measures to try to contain the virus. These efforts include travel bans and restrictions, quarantines, shelter-in-place/stay-at-home and social distancing orders, and shutdowns. These measures have impacted and may further impact our workforce and operations, the operations of our customers, and those of our vendors, suppliers and manufacturing partners. The extent to which the COVID-19 pandemic will continue to affect our business, results of operation and financial condition is difficult to predict and depends on numerous evolving factors, including: the duration and scope of the pandemic; government, social, business and other actions that have been and will be taken in response to the pandemic; and the effect of the pandemic on short- and long-term general economic conditions.

While our manufacturing partners and component suppliers mostly have been able to continue to operate to date in compliance with applicable regulations and current limitations, future restrictions on their operations could impact our ability to meet customer demand and could have a material adverse effect on our financial condition and results of operations, particularly if prolonged. Similarly, current and future restrictions or disruptions of transportation, such as reduced availability of air transport, port closures, and increased border controls or closures, can also impact our ability to meet demand and could materially adversely affect us. We have already observed a significant increase in the cost of air freight as a result of the pandemic, which negatively affects our profitability as we seek to transport an increased number of products from manufacturing locations in Asia to other markets around the world as quickly as possible. In addition, rapidly shifting consumer demand during the pandemic can lead to unexpected results of operations. Although we have seen a significant increase in demand for our Connected Home products due to consumers responding to work-from-home and shelter-in-place measures, we do not know how long this increase may last. This unanticipated increase in demand has put strain on our manufacturing partners, suppliers and logistics partners to produce and deliver a sufficient number of products to meet this demand. We also have seen a weakening in demand for our SMB products as businesses reacted to the uncertainty caused by the pandemic and placed projects on hold. Because of this shift in demand, and the fact that our SMB products generally have higher gross margins than our Connected Home products, our overall profitability and other financial results have been, and could continue to be, negatively impacted.

The pandemic has significantly increased economic and demand uncertainty and also has led to increased disruption and volatility in capital markets and credit markets. It is likely that the current severe economic slowdown resulting from the pandemic could lead to a global recession. There is a significant degree of uncertainty and lack of visibility as to the extent and duration of any such slowdown or recession. Risks related to a slowdown or recession include the risk that demand for our products will be significantly harmed over time, if consumers choose to delay product upgrades or various projects in order to conserve funds. Given the significant economic uncertainty and volatility created by the pandemic, it is difficult to predict the nature and extent of impacts on demand for our products. These expectations are subject to change without warning.

The spread of COVID-19 has caused us to modify our business practices (including employee travel, employee work locations, cancellation of physical participation in meetings, events and conferences, and social distancing measures), and we may take further actions as may be required by government authorities or that we determine are in the best interests of our employees, customers, partners, vendors, and suppliers. Work-from-home and other measures introduce additional operational risks, including cybersecurity risks, and have affected the way we conduct our product development, testing, customer support, and other activities, which could have an adverse effect on our operations. Furthermore, we rely on third-party laboratories to test and certify our products. If these service providers close or reduce staffing, it could delay our product development efforts. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus, and illness and workforce disruptions could lead to unavailability of key personnel and harm our ability to perform critical functions. In addition, work-from-home and related business practice modifications present significant challenges to maintaining our corporate culture, including employee engagement and productivity, both during the immediate pandemic crisis and as we make additional adjustments in the eventual transition from it.

The degree to which COVID-19 impacts our results will depend on future developments, which are highly uncertain and cannot be predicted, including how quickly and to what extent normal economic and operating conditions can resume. We are similarly unable to predict the degree to which the pandemic impacts our customers, suppliers, vendors, and other partners, and their financial conditions, but a material effect on these parties could also adversely affect us. The impact of COVID-19 can also exacerbate other risks discussed below, which could in turn have a material adverse effect on us. Developments related to COVID-19 have been rapidly changing, and additional impacts and risks may arise that we are not aware of or able to appropriately respond to currently.

***We expect our operating results to fluctuate on a quarterly and annual basis, which could cause our stock price to fluctuate or decline.**

Our operating results are difficult to predict and may fluctuate substantially from quarter-to-quarter or year-to-year for a variety of reasons, many of which are beyond our control. If our actual results were to fall below our estimates or the expectations of public market analysts or investors, our quarterly and annual results would be negatively impacted and the price of our stock could decline. Other factors that could affect our quarterly and annual operating results include those listed in the risk factors section of this report and others such as:

- the duration and impact of the COVID-19 pandemic, particularly on our supply chain, our channel partners and our end market sales;
- changes in the pricing policies of or the introduction of new products by us or our competitors;
- the inability to maintain stable operations by our suppliers and other parties with which we have commercial relationships;
- component supply constraints or sudden, unforeseen price increases from our vendors;
- unanticipated increases in costs, including air freight, associated with shipping and delivery of our products;

- shift in overall product mix sales from higher to lower gross margin products, or from one business segment to another, that would adversely impact our gross margins;
- operational disruptions, such as transportation delays or failure of our order processing system, particularly if they occur at the end of a fiscal quarter;
- introductions of new technologies and changes in consumer preferences that result in either unanticipated or unexpectedly rapid product category shifts;
- slow or negative growth in the networking product, personal computer, Internet infrastructure, smart home, home electronics and related technology markets;
- seasonal shifts in end market demand for our products, particularly in our Connected Home business segment;
- delays in the introduction of new products by us or market acceptance of these products;
- increases in expenses related to the development, introduction and marketing of new products that adversely impact our margins;
- unanticipated decreases or delays in purchases of our products by our significant traditional and online retail customers;
- unexpected challenges or delays in our ability to further develop services and applications that complement our products and result in meaningful subscriber growth and future recurring revenue;
- discovery or exploitation of security vulnerabilities in our products, services or systems, leading to negative publicity, decreased demand or potential liability, including potential breach of our customers' data privacy or disruption of the continuous operation of our cloud infrastructure and our products;
- changes in U.S. and international tax and trade policy that adversely affect customs, tax or duty rates, such as the higher tariffs on products imported from China enacted by the current U.S. administration;
- foreign currency exchange rate fluctuations in the jurisdictions where we transact sales and expenditures in local currency;
- unanticipated increases in expenses related to periodic restructuring measures undertaken to achieve profitability and other business goals, including the reallocation or relocation of resources;
- unfavorable level of inventory and turns;
- changes in or consolidation of our sales channels and wholesale distributor relationships or failure to manage our sales channel inventory and warehousing requirements;
- delay or failure to fulfill orders for our products on a timely basis;
- delay or failure of our service provider customers to purchase at their historic volumes or at the volumes that they or we forecast;
- changes in tax rates or adverse changes in tax laws that expose us to additional income tax liabilities;
- disruptions or delays related to our financial and enterprise resource planning systems;

- our inability to accurately forecast product demand, resulting in increased inventory exposure;
- allowance for doubtful accounts exposure with our existing retailers, distributors and other channel partners and new retailers, distributors and other channel partners, particularly as we expand into new international markets;
- geopolitical disruption, including sudden changes in immigration policies, leading to disruption in our workforce or delay or even stoppage of our operations in manufacturing, transportation, technical support and research and development;
- terms of our contracts with customers or suppliers that cause us to incur additional expenses or assume additional liabilities;
- an increase in price protection claims, redemptions of marketing rebates, product warranty and stock rotation returns or allowance for doubtful accounts;
- litigation involving alleged patent infringement, consumer class actions, securities class actions or other claims that could negatively impact our reputation, brand, business and financial condition;
- epidemic or widespread product failure, performance problems or unanticipated safety issues in one or more of our products that could negatively impact our reputation, brand and business;
- any changes in accounting rules;
- challenges associated with integrating acquisitions that we make, or with realizing value from our strategic investments in other companies;
- failure to effectively manage our third party customer support partners, which may result in customer complaints and/or harm to the NETGEAR brand;
- our inability to monitor and ensure compliance with our code of ethics, our anti-corruption compliance program and domestic and international anti-corruption laws and regulations, whether in relation to our employees or with our suppliers or customers;
- labor unrest at facilities managed by our third-party manufacturers;
- workplace or human rights violations in certain countries in which our third-party manufacturers or suppliers operate, which may affect the NETGEAR brand and negatively affect our products' acceptance by consumers;
- unanticipated shifts or declines in profit by geographical region that would adversely impact our tax rate; and
- our failure to implement and maintain the appropriate internal controls over financial reporting which may result in restatements of our financial statements.

As a result, period-to-period comparisons of our operating results may not be meaningful, and you should not rely on them as an indication of our future performance.

Some of our competitors have substantially greater resources than we do, and to be competitive we may be required to lower our prices or increase our sales and marketing expenses, which could result in reduced margins or loss of market share.

We compete in a rapidly evolving and fiercely competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors in the consumer market include ARRIS, ASUS, AVM, Devolo, D-Link, Eero (owned by Amazon), Lenovo, Nest (owned by Google), Linksys (owned by Foxconn), Samsung,

Synology and TP-Link. Our principal competitors in the business market include Allied Telesys, Barracuda, Buffalo, Cisco Systems, Dell, D-Link, Fortinet, Hewlett-Packard Enterprise, QNAP Systems, Seagate Technology, SonicWall, Synology, TP-Link, Ubiquiti, WatchGuard and Western Digital. Our principal competitors in the service provider market include Actiontec, Airties, Arcadyan, ARRIS, ASUS, AVM, Compal Broadband, D-Link, Eero (owned by Amazon), Franklin, Google, Hitron, Huawei, Inseego, Plume, Sagem, Sercomm, SMC Networks, TechniColor, TP-Link, Ubee, ZTE and Zyxel. Other competitors include numerous local vendors such as Xiaomi in China, AVM in Germany and Buffalo in Japan. In addition, these local vendors may target markets outside of their local regions and may increasingly compete with us in other regions worldwide. Our potential competitors also include other consumer electronics vendors, including Apple, LG Electronics, Microsoft, Panasonic, Sony, Toshiba and Vizio, who could integrate networking and streaming capabilities into their line of products, such as televisions, set top boxes and gaming consoles, and our channel customers who may decide to offer self-branded networking products. We also face competition from service providers who may bundle a free networking device with their broadband service offering, which would reduce our sales if we were not the supplier of choice to those service providers. In the service provider space, we are also facing significant and increased competition from original design manufacturers, or ODMs, and contract manufacturers who are selling and attempting to sell their products directly to service providers around the world.

Many of our existing and potential competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. These competitors may, among other things, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, obtain more favorable pricing from suppliers and manufacturers, and exert more influence on sales channels than we can. Certain of our significant competitors also serve as key sales and marketing channels for our products, potentially giving these competitors a marketplace advantage based on their knowledge of our business activities and/or their ability to negatively influence our sales opportunities. For example, Amazon provides an important sales channel for our products, but it also competes with us in the mesh WiFi systems product category through its subsidiary Eero. In addition, certain competitors may have different business models, such as integrated manufacturing capabilities, that may allow them to achieve cost savings and to compete on the basis of price. Other competitors may have fewer resources, but may be more nimble in developing new or disruptive technology or in entering new markets. We anticipate that current and potential competitors will also intensify their efforts to penetrate our target markets. For example, price competition is intense in our industry in certain geographical regions and product categories. Many of our competitors in the service provider and retail spaces price their products significantly below our product costs in order to gain market share. Certain substantial competitors have business models that are more focused on customer acquisition and access to customer data rather than on financial return from product sales, and these competitors have the ability to provide sustained price competition to many of our products in the market. Average sales prices have declined in the past and may again decline in the future. These competitors may have more advanced technology, more extensive distribution channels, stronger brand names, greater access to shelf space in retail locations, bigger promotional budgets and larger customer bases than we do. In addition, many of these competitors leverage a broader product portfolio and offer lower pricing as part of a more comprehensive end-to-end solution which we may not have. These companies could devote more capital resources to develop, manufacture and market competing products than we could. Our competitors may acquire other companies in the market and leverage combined resources to gain market share. In some instances, our competitors may be acquired by larger companies with additional formidable resources, such as the purchase of ARRIS by CommScope and Eero by Amazon. If any of these companies are successful in competing against us, our sales could decline, our margins could be negatively impacted and we could lose market share, any of which could seriously harm our business and results of operations.

***Global economic conditions could materially adversely affect our revenue and results of operations.**

Our business has been and may continue to be affected by a number of factors that are beyond our control, such as general geopolitical, economic and business conditions, conditions in the financial markets, and changes in the overall demand for networking and smart home products. A severe and/or prolonged economic downturn could adversely affect our customers' financial condition and the levels of business activity of our customers. Weakness in, and uncertainty about, global economic conditions may cause businesses to postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for networking products. As also noted in the risk factor "The COVID-19 pandemic could materially adversely affect our financial condition and results of operations," above, the COVID-19 pandemic has significantly increased economic and demand uncertainty. It is likely that the current severe economic slowdown resulting from the pandemic could lead to a global recession. Adverse changes in economic conditions, including as a result of the pandemic, can significantly harm demand for our products (or change the mix of products demanded) and make it more challenging to forecast our operating results and make business decisions.

In addition, availability of our products from third-party manufacturers and our ability to distribute our products into the United States and non-U.S. jurisdictions may be impacted by factors such as an increase in duties, tariffs or other restrictions on trade; raw material shortages, work stoppages, strikes and political unrest; economic crises and international disputes or conflicts; changes in leadership and the political climate in countries from which we import products; and failure of the United States to maintain normal trade relations with China and other countries. Any of these occurrences could materially adversely affect our business, operating results and financial condition.

In the recent past, various regions worldwide have experienced slow economic growth. In addition, current economic challenges in China, including any global economic ramifications of these challenges, may continue to put negative pressure on global economic conditions. If conditions in the global economy, including Europe, China, Australia and the United States, or other key vertical or geographic markets deteriorate, such conditions could have a material adverse impact on our business, operating results and financial condition. For example, during the second half of 2019, our APAC sales were dampened by a sudden economic downturn in the China/Hong Kong region due to the escalating trade war, Yuan depreciation and the unstable sociopolitical situation in Hong Kong. These same factors have also negatively impacted financial institutions on which we rely, which could further disrupt our business in the region or limit our ability to access certain assets. If we are unable to successfully anticipate changing economic and political conditions, we may be unable to effectively plan for and respond to those changes, which could materially adversely affect our business and results of operations.

In addition, the economic problems affecting the financial markets and the uncertainty in global economic conditions resulted in a number of adverse effects including a low level of liquidity in many financial markets, extreme volatility in credit, equity, currency and fixed income markets, instability in the stock market and high unemployment. For example, the challenges faced by the European Union to stabilize some of its member economies, such as Greece, Portugal, Spain, Hungary and Italy, have had international implications affecting the stability of global financial markets and hindering economies worldwide. Many member nations in the European Union have been addressing the issues with controversial austerity measures. In addition, the consequences of the recent "BREXIT" process by the United Kingdom and the current transition have led to significant uncertainty in the region. Should the European Union monetary policy measures be insufficient to restore confidence and stability to the financial markets, or should the United Kingdom's "BREXIT" transition lead to additional economic or political instability, the global economy, including the U.S., U.K. and European Union economies where we have a significant presence, could be hindered, which could have a material adverse effect on us. There could also be a number of other follow-on effects from these economic developments on our business, including the inability of customers to obtain credit to finance purchases of our products; customer insolvencies; decreased customer confidence to make purchasing decisions; decreased customer demand; and decreased customer ability to pay their trade obligations.

***We depend on a limited number of third-party manufacturers for substantially all of our manufacturing needs. If these third-party manufacturers experience any delay, disruption or quality control problems in their operations, we could lose market share and our brand may suffer.**

All of our products are manufactured, assembled, tested and generally packaged by a limited number of third-party manufacturers, including original design manufacturers, or ODMs, as well as contract manufacturers. In most cases, we rely on these manufacturers to procure components and, in some cases, subcontract engineering work. Some of our products are manufactured by a single manufacturer. We do not have any long-term contracts with any of our third-party manufacturers. Some of these third-party manufacturers produce products for our competitors or are themselves competitors in certain product categories. Due to changing economic conditions, the viability of some of these third-party manufacturers may be at risk. Our ODMs are increasingly refusing to work with us on certain projects, such as projects for manufacturing products for our service provider customers. Because our service provider customers command significant resources, including for software support, and demand extremely competitive pricing, our ODMs are starting to refuse to engage on service provider terms. The loss of the services of any of our primary third-party manufacturers could cause a significant disruption in operations and delays in product shipments. Qualifying a new manufacturer and commencing volume production is expensive and time consuming. Ensuring that a contract manufacturer is qualified to manufacture our products to our standards is time consuming. In addition, there is no assurance that a contract manufacturer can scale its production of our products at the volumes and in the quality that we require. If a contract manufacturer is unable to do these things, we may have to move production for the products to a new or existing third party manufacturer which would

take significant effort and our business may be harmed. In addition, as we recently have transitioned a substantial portion of our manufacturing facilities to different jurisdictions, we are subject to additional significant challenges in ensuring that quality, processes and costs, among other issues, are consistent with our expectations. For example, while we expect our manufacturers to be responsible for penalties assessed on us because of excessive failures of the products, there is no assurance that we will be able to collect such reimbursements from these manufacturers, which causes us to take on additional risk for potential failures of our products.

Our reliance on third-party manufacturers also exposes us to the following risks over which we have limited control:

- unexpected increases in manufacturing and repair costs;
- inability to control the quality and reliability of finished products;
- inability to control delivery schedules;
- potential liability for expenses incurred by third-party manufacturers in reliance on our forecasts that later prove to be inaccurate;
- potential lack of adequate capacity to manufacture all or a part of the products we require; and
- potential labor unrest affecting the ability of the third-party manufacturers to produce our products.

All of our products must satisfy safety and regulatory standards and some of our products must also receive government certifications. Our third party manufacturers are primarily responsible for conducting the tests that support our applications for most regulatory approvals for our products. If our third party manufacturers fail to timely and accurately conduct these tests, we would be unable to obtain the necessary domestic or foreign regulatory approvals or certificates to sell our products in certain jurisdictions. As a result, we would be unable to sell our products and our sales and profitability could be reduced, our relationships with our sales channel could be harmed, and our reputation and brand would suffer.

Specifically, substantially all of our manufacturing and assembly occurs in the Asia Pacific region, and any disruptions due to natural disasters, health epidemics and political, social and economic instability in the region would affect the ability of our third party manufacturers to manufacture our products. For example, as also noted in the risk factor “The COVID-19 pandemic could materially adversely affect our financial condition and results of operations,” above, the outbreak of the COVID-19 pandemic has led to the temporary closure of many factories, businesses, schools and public spaces, as well as travel restrictions impacting the movement of people and goods. If these closures and restrictions continue for a substantial period of time, they may disrupt important elements of our supply chain, including the operation of our third party manufacturing facilities and other key service providers, the availability of labor, and the supply of necessary components. If the cost of production charged by our third party manufacturers increases, it may affect our margins and ability to lower prices for our products to stay competitive. Labor unrest in Southeast Asia, China or other locations where our products are manufactured may also affect our third party manufacturers as workers may strike and cause production delays. If our third party manufacturers fail to maintain good relations with their employees or contractors, and production and manufacturing of our products is affected, then we may be subject to shortages of products and quality of products delivered may be affected. Further, if our manufacturers or warehousing facilities are disrupted or destroyed, we would have no other readily available alternatives for manufacturing and assembling our products and our business would be significantly harmed.

As we continue to work with more third party manufacturers on a contract manufacturing basis, we are also exposed to additional risks not inherent in a typical ODM arrangement. Such risks may include our inability to properly source and qualify components for the products, lack of software expertise resulting in increased software defects, and lack of resources to properly monitor the manufacturing process. In our typical ODM arrangement, our ODMs are generally responsible for sourcing the components of the products and warranting that the products will work against a product's specification, including any software specifications. In a contract manufacturing arrangement, we would take on much more, if not all, of the responsibility around these areas. If we are unable to properly manage these risks, our products may be more susceptible to defects and our business would be harmed.

***We obtain several key components from limited or sole sources, and if these sources fail to satisfy our supply requirements or we are unable to properly manage our supply requirements with our third-party manufacturers, we may lose sales and experience increased component costs.**

Any shortage or delay in the supply of key product components, or any sudden, unforeseen price increase for such components, would harm our ability to meet product deliveries as scheduled or as budgeted. Many of the semiconductors used in our products are specifically designed for use in our products and are obtained from sole source suppliers on a purchase order basis. In addition, some components that are used in all our products are obtained from limited sources. These components include connector jacks, plastic casings and physical layer transceivers. We also obtain switching fabric semiconductors, which are used in our Ethernet switches and Internet gateway products, and wireless local area network chipsets, which are used in all of our wireless products, from a limited number of suppliers. Semiconductor suppliers have experienced and continue to experience component shortages themselves, such as with substrates used in manufacturing chipsets, which in turn adversely impact our ability to procure semiconductors from them. Our third-party manufacturers generally purchase these components on our behalf on a purchase order basis, and we do not have any contractual commitments or guaranteed supply arrangements with our suppliers. If demand for a specific component increases, we may not be able to obtain an adequate number of that component in a timely manner. For example, as also noted in the risk factor “The COVID-19 pandemic could materially adversely affect our financial condition and results of operations,” above, the outbreak of the COVID-19 pandemic has led to increased demand for our Connected Home products. Shortages of key components used to manufacture these products and long lead times in ordering additional components have, in some cases, limited our ability to manufacture products in the volumes needed to fully meet this demand. In addition, if worldwide demand for the components increases significantly, the availability of these components could be limited. Further, our suppliers may experience financial or other difficulties as a result of uncertain and weak worldwide economic conditions. Other factors which may affect our suppliers' ability or willingness to supply components to us include internal management or reorganizational issues, such as roll-out of new equipment which may delay or disrupt supply of previously forecasted components, or industry consolidation and divestitures, which may result in changed business and product priorities among certain suppliers. Also, many standardized components used broadly in electronic devices are manufactured in significant quantities in concentrated geographic regions, particularly in Greater China. As a result, protracted crises, such as the COVID-19 pandemic, could lead to eventual shortages of necessary components sourced from impacted regions. It could be difficult, costly and time consuming to obtain alternative sources for these components, or to change product designs to make use of alternative components. In addition, difficulties in transitioning from an existing supplier to a new supplier could create delays in component availability that would have a significant impact on our ability to fulfill orders for our products.

We provide our third-party manufacturers with a rolling forecast of demand, which they use to determine our material and component requirements. Lead times for ordering materials and components vary significantly and depend on various factors, such as the specific supplier, contract terms and demand and supply for a component at a given time. Some of our components have long lead times, such as wireless local area network chipsets, switching fabric chips, physical layer transceivers, connector jacks and metal and plastic enclosures. If our forecasts are not timely provided or are less than our actual requirements, our third-party manufacturers may be unable to manufacture products in a timely manner. If our forecasts are too high, our third-party manufacturers will be unable to use the components they have purchased on our behalf. The cost of the components used in our products tends to drop rapidly as volumes increase and the technologies mature. Therefore, if our third-party manufacturers are unable to promptly use components purchased on our behalf, our cost of producing products may be higher than our competitors due to an oversupply of higher-priced components. Moreover, if they are unable to use components ordered at our direction, we will need to reimburse them for any losses they incur.

If we are unable to obtain a sufficient supply of components, or if we experience any interruption in the supply of components, our product shipments could be reduced or delayed or our cost of obtaining these components may increase. Component shortages and delays affect our ability to meet scheduled product deliveries, damage our brand and reputation in the market, and cause us to lose sales and market share. For example, component shortages and disruptions in supply in the past have limited our ability to supply all the worldwide demand for our products, and our revenue was affected. At times we have elected to use more expensive transportation methods, such as air freight, to make up for manufacturing delays caused by component shortages, which reduces our margins. In addition, at times sole suppliers of highly specialized components have provided components that were either defective or did not meet the criteria required by our customers, resulting in delays, lost revenue opportunities and potentially substantial write-offs.

If we fail to continue to introduce or acquire new products and services that achieve broad market acceptance on a timely basis, we will not be able to compete effectively and we will be unable to increase or maintain net revenue and gross margins.

We operate in a highly competitive, quickly changing environment, and our future success depends on our ability to develop or acquire, and introduce new products and services that achieve broad market acceptance. Our future success will depend in large part upon our ability to identify demand trends in the consumer, business and service provider markets, and to quickly develop or acquire, and manufacture and sell products and services that satisfy these demands in a cost-effective manner. In order to differentiate our products from our competitors' products, we must continue to increase our focus and capital investment in research and development, including software development for our products and complementary services and applications. For example, we have committed a substantial amount of resources to the development, manufacture, marketing and sale of our Nighthawk home networking products and Orbi WiFi system, and to introducing additional and improved models in these lines. If these products do not continue to maintain or achieve widespread market acceptance, or if we are unsuccessful in capitalizing on other smart home market opportunities, our future growth may be slowed and our financial results could be harmed. Also, as the mix of our business increasingly includes new products and services that require additional investment, this shift may adversely impact our margins, at least in the near-term. For example, we are making significant investments in the development and introduction of our new WiFi 6 products, including marketing efforts to build awareness of the benefits of this next-generation WiFi standard. Successfully predicting demand trends is difficult, and it is very difficult to predict the effect that introducing a new product will have on existing product sales. We will also need to respond effectively to new product announcements by our competitors by quickly introducing competitive products.

In addition, we have acquired companies and technologies in the past and as a result, have introduced new product lines in new markets. We may not be able to successfully manage integration of the new product lines with our existing products. Selling new product lines in new markets will require our management to learn different strategies in order to be successful. We may be unsuccessful in launching a newly acquired product line in new markets which requires management of new suppliers, potential new customers and new business models. Our management may not have the experience of selling in these new markets and we may not be able to grow our business as planned. For example, in August 2018, we acquired Meural Inc., a leader in digital platforms for visual art, to enhance our Connected Home product and service offerings. If we are unable to effectively and successfully further develop these new product lines, we may not be able to increase or maintain our sales and our gross margins may be adversely affected.

We have experienced delays and quality issues in releasing new products in the past, which resulted in lower quarterly net revenue than expected. In addition, we have experienced, and may in the future experience, product introductions that fall short of our projected rates of market adoption. Online Internet reviews of our products are increasingly becoming a significant factor in the success of our new product launches, especially in our Connected Home business segment. If we are unable to quickly respond to negative reviews, including end user reviews posted on various prominent online retailers, our ability to sell these products will be harmed. Any future delays in product development and introduction, or product introductions that do not meet broad market acceptance, or unsuccessful launches of new product lines could result in:

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and brand;
- a decline in the average selling price of our products;
- adverse reactions in our sales channels, such as reduced shelf space, reduced online product visibility, or loss of sales channels; and
- increased levels of product returns.

Throughout the past few years, we have significantly increased the rate of our new product introductions. If we cannot sustain that pace of product introductions, either through rapid innovation or acquisition of new products or product lines, we may not be able to maintain or increase the market share of our products. In addition, if we are unable to successfully introduce or acquire new products with higher gross margins, or if we are unable to improve the margins on our previously introduced and rapidly growing product lines, our net revenue and overall gross margin would likely decline.

***We rely on a limited number of traditional and online retailers, wholesale distributors and service provider customers for a substantial portion of our sales, and our net revenue could decline if they refuse to pay our requested prices or reduce their level of purchases, if there are unforeseen disruptions in their businesses, or if there is significant consolidation in our customer base that results in fewer customers for our products.**

We sell a substantial portion of our products through traditional and online retailers, including Best Buy Co., Inc., Amazon.com, Inc. and their affiliates, wholesale distributors, including Ingram Micro, Inc. and Tech Data Corporation, and service providers, such as AT&T. We expect that a significant portion of our net revenue will continue to come from sales to a small number of customers for the foreseeable future. In addition, because our accounts receivable are often concentrated with a small group of purchasers, the failure of any of them to pay on a timely basis, or at all, would reduce our cash flow. We are also exposed to increased credit risk if any one of these limited numbers of customers fails or becomes insolvent. We generally have no minimum purchase commitments or long-term contracts with any of these customers. These purchasers could decide at any time to discontinue, decrease or delay their purchases of our products. If our customers increase the size of their product orders without sufficient lead-time for us to process the order, our ability to fulfill product demands would be compromised. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. Accordingly, the prices that they pay for our products are subject to negotiation and could change at any time. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If any of our major customers reduce their level of purchases or refuse to pay the prices that we set for our products, our net revenue and operating results could be harmed.

Furthermore, some of our customers are also our competitors in certain product categories, which could negatively influence their purchasing decisions. For example, Amazon owns Eero, one of our competitors in the mesh WiFi systems product category. Our traditional retail customers have faced increased and significant competition from online retailers, and some of these traditional retail customers have increasingly become a smaller portion of our business. If key retail customers continue to reduce their level of purchases, our business could be harmed. In addition, unforeseen disruptions in the businesses of any of our key customers could adversely impact the sale of our products to end users and the quantity of products our customers decide to purchase from us. For example, as also noted in the risk factor “The COVID-19 pandemic could materially adversely affect our financial condition and results of operations,” above, the unexpected need of many of our retail customers to close their physical locations due to the pandemic forced them to rapidly shift to online methods of selling products. This shift may have a longer-term impact on the inventory levels these customers choose to carry. Also during the pandemic, some channel partners have prioritized the sale and delivery of other categories of products ahead of ours.

Additionally, concentration and consolidation among our customer base may allow certain customers to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. If, as a result of increased leverage, customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our products to a particular customer, which could result in a decrease in our revenue. Consolidation among our customer base may also lead to reduced demand for our products, elimination of sales opportunities, replacement of our products with those of our competitors and cancellations of orders, each of which would harm our operating results. Consolidation among our service provider customers worldwide may also make it more difficult to grow our service provider business, given the fierce competition for the already limited number of service providers worldwide and the long sales cycles to close deals. If consolidation among our customer base becomes more prevalent, our operating results may be harmed.

***Product security vulnerabilities, system security risks, data protection breaches and cyber-attacks could disrupt our products, services, internal operations or information technology systems, and any such disruption could increase our expenses, damage our reputation, harm our business and adversely affect our stock price.**

Our products and services may contain unknown security vulnerabilities. For example, the firmware, software and open source software that we or our manufacturing partners have installed on our products may be susceptible to hacking or misuse. We devote considerable time and resources to uncovering and remedying these vulnerabilities, using both internal and external resources. We may not be able to discover these vulnerabilities, and we may not be able to remedy these vulnerabilities in a timely manner, or at all, which may impact our brand and reputation and harm our business. Under certain circumstances, we may need to prioritize fixing these vulnerabilities over new product development, which may impact our revenues and adversely affect our business.

In addition, we offer a comprehensive online cloud management service paired with a number of our products. If malicious actors compromise this cloud service, or if customer confidential information is accessed without authorization, our business will be harmed. Operating an online cloud service is a relatively new business for us and we may not have the expertise to properly manage risks related to data security and systems security. In addition, we have recently started to make our products available for purchase directly by consumers through our website. We rely on third-party providers for a number of critical aspects of our cloud services, e-commerce site and customer support, including web hosting services, billing and payment processing, and consequently we do not maintain direct control over the security or stability of the associated systems.

Maintaining the security of our computer information systems and communication systems is a critical issue for us and our customers. Malicious actors may develop and deploy malware that is designed to manipulate our products and systems, including our internal network, or those of our vendors or customers. Additionally, outside parties may attempt to fraudulently induce our employees to disclose sensitive information in order to gain access to our information technology systems, our data or our customers' data. We have established a crisis management plan and business continuity program. While we regularly test the plan and the program, there can be no assurance that the plan and program can withstand an actual or serious disruption in our business, including a data protection breach or cyber-attack. While we have established infrastructure and geographic redundancy for our critical systems, our ability to utilize these redundant systems requires further testing and we cannot be assured that such systems are fully functional. For example, much of our order fulfillment process is automated and the order information is stored on our servers. A significant business interruption could result in losses or damages and harm our business. As a result of the COVID-19 pandemic, discussed further in the risk factor "The COVID-19 pandemic could materially adversely affect our financial condition and results of operations," above, most of our major offices worldwide have enacted shelter-in-place measures, with employees being mandated to work from home. These working from home arrangements present additional cybersecurity risks, including potential increases in malware and phishing attacks, greater challenges to secure home office data, and potential service degradation or disruption to key internal business applications and third-party services. Although we have taken measures to address these risks, they present challenges that could impact business operations and could cause recovery times to increase. If our computer systems and servers become unavailable at the end of a fiscal quarter, our ability to recognize revenue may be delayed until we are able to utilize back-up systems and continue to process and ship our orders. This could cause our stock price to decline significantly.

We devote considerable internal and external resources to network security, data encryption and other security measures to protect our systems and customer data, but these security measures cannot provide absolute security. In addition, many jurisdictions strictly regulate data privacy and protection and may impose significant penalties for failure to comply with these requirements. For example, the European Union's General Data Protection Regulation ("GDPR"), which became effective in May 2018, has required us to expend significant time and resources to prepare for compliance. Data Protection Authorities in Europe have begun to aggressively enforce the GDPR and have issued heavy fines for non-compliance against a broad range of companies. The State of California has enacted the California Consumer Privacy Act of 2018 (the "CCPA"), which became effective in January 2020. The CCPA establishes a privacy framework for covered businesses, including an expansive definition of personal information and data privacy rights for California residents. The CCPA includes potentially severe statutory damages and private rights of action. The CCPA requires covered companies to provide new disclosures to California consumers (as broadly defined in the CCPA), provide such consumers new ways to opt-out of certain sales of personal information, and allow for a new cause of action for data breaches. It remains unclear

how the CCPA will be interpreted, but as currently written, it will likely impact our business activities and it exemplifies the vulnerability of our business not only to cyber threats but also the evolving regulatory environment related to personal data. The CCPA is likely to increase our compliance costs and potential liability. Some observers have noted that the CCPA could mark the beginning of a trend toward more stringent privacy legislation in the United States, and other states are beginning to pass similar laws.

Compliance with these and any other applicable privacy and data security laws and regulations is a rigorous and time-intensive process, and we may be required to put in place additional mechanisms ensuring compliance with the new data protection rules. If we fail to comply with any such laws or regulations, we may face significant fines and penalties that could adversely affect our business, financial condition and results of operations. Furthermore, the laws are not consistent, and compliance in the event of a widespread data breach is costly.

Potential breaches of our security measures and the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us, our employees or our customers, including the potential loss or disclosure of such information or data as a result of employee error or other employee actions, hacking, fraud, social engineering or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, subject us to significant governmental fines, damage our brand and reputation, or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant. Likewise, we expect that there will continue to be new proposed laws, regulations and industry standards relating to privacy and data protection in the United States, the EU and other jurisdictions, such as the CCPA. We cannot presently determine the impact such laws, regulations and standards will have on our business. In any event, it is possible that governmental authorities will conclude that our business practices do not comply with current or future statutes, regulations, agency guidance or case law involving applicable healthcare or privacy laws, including the GDPR, in light of the lack of applicable precedent and regulations.

Our management has spent increasing amounts of time, effort and expense in this area, and in the event of the discovery of a significant product or system security vulnerability, we would incur additional substantial expenses and our business would be harmed. If we or our third-party providers are unable to successfully prevent breaches of security relating to our products, services, systems or customer private information, including customer personal identification information, or if these third-party systems failed for other reasons, it could result in litigation and potential liability for us, damage our brand and reputation, or otherwise harm our business.

Changes in trade policy in the United States and other countries, including the imposition of tariffs and the resulting consequences, may adversely impact our business, results of operations and financial condition.

The U.S. government has indicated and demonstrated its intent to alter its approach to international trade policy through the renegotiation, and potential termination, of certain existing bilateral or multi-lateral trade agreements and treaties with, and the imposition of tariffs on a wide range of products and other goods from, a number of countries. In particular, the U.S. government has been engaged in extended trade negotiations with China, which has resulted in the implementation of tariffs on a significant number of products manufactured in China and imported into the United States. Since June 1, 2018, the U.S. government has been subjecting various classifications of items that are considered to be of China origin to additional duties under Section 301 of the U.S. Trade Act of 1974. During 2018, the U.S. Trade Representative (“USTR”) announced three separate tranches of items (known as lists 1, 2 and 3) that carried additional Section 301 duties if the items were products of China. Currently, items on lists 1 through 3 carry penalty duty rates of 25% on items of China origin. On August 13, 2019, the USTR announced the issuance of two additional lists (known as lists 4a and 4b), having effective dates of September 1, 2019 and December 15, 2019, respectively. During the period of implementation of List 4a and 4b, the U.S. and Chinese governments negotiated a trade truce that was known as the “Phase I” trade deal. The Phase I trade deal was signed on January 15, 2020. Among other things, the Phase I deal reduced the tariff on List 4a items from 15% to 7.5% (effective for items withdrawn for consumption on or after February 14, 2020) and indefinitely delayed tariffs of List 4b items. Items classified on Lists 1, 2 and 3 remain unchanged. Discussions between the U.S. government and China are ongoing and uncertain in nature. Throughout the extended negotiations, the U.S. government has not only threatened increases to the Section 301 tariffs, but has taken action. Our analysis of our supply chain, manufacturing processes and product compositions is ongoing, but our review to date indicates that most of

our product types fall under the currently effective lists discussed above, if the item was deemed to be a product of China. Although we have been working closely with our manufacturing partners to implement ways to mitigate the impact of these tariffs on our supply chain as promptly as reasonably practicable, including shifting production outside of China, these efforts may disrupt our operations, may not be completely successful and may result in higher long-term manufacturing costs. Moreover, there is no certainty that countries to which we have shifted our manufacturing operations will not be subject to similar tariffs in the future. As a result, we may be required to raise our prices on certain products, which could result in the loss of customers and harm to our market share, competitive position and operating performance.

Additionally, the imposition of tariffs is dependent upon the classification of items under the Harmonized Tariff System ("HTS") and the country of origin of the item. Determination of the HTS and the origin of the item is a technical matter that can be subjective in nature. Accordingly, although we believe our classifications of both HTS and origin are appropriate, there is no certainty that the U.S. government will agree with us. If the U.S. government does not agree with our determinations, we could be required to pay additional amounts, including potential penalties, and our profitability would be adversely impacted.

We depend on large, recurring purchases from certain significant customers, and a loss, cancellation or delay in purchases by these customers could negatively affect our revenue.

The loss of recurring orders from any of our more significant customers could cause our revenue and profitability to suffer. Our ability to attract new customers will depend on a variety of factors, including the cost-effectiveness, reliability, scalability, breadth and depth of our products. In addition, a change in the mix of our customers, or a change in the mix of direct and indirect sales, could adversely affect our revenue and gross margins.

Although our financial performance may depend on large, recurring orders from certain customers and resellers, we do not generally have binding commitments from them. For example:

- our reseller agreements generally do not require substantial minimum purchases;
- our customers can stop purchasing and our resellers can stop marketing our products at any time; and
- our reseller agreements generally are not exclusive.

Further, our revenue may be impacted by significant one-time purchases which are not contemplated to be repeatable. While such purchases are reflected in our financial statements, we do not rely on and do not forecast for continued significant one-time purchases. As a result, lack of repeatable one-time purchases will adversely affect our revenue.

Because our expenses are based on our revenue forecasts, a substantial reduction or delay in sales of our products to, or unexpected returns from, customers and resellers, or the loss of any significant customer or reseller, could harm or otherwise have a negative impact to our operating results. Although our largest customers may vary from period to period, we anticipate that our operating results for any given period will continue to depend on large orders from a small number of customers.

We have been and will be investing increased additional in-house resources on software research and development, which could disrupt our ongoing business and present distinct risks from our historically hardware-centric business.

We plan to continue to evolve our historically hardware-centric business model towards a model that includes more sophisticated software offerings, including services and applications that complement our products and are intended to drive subscriber growth and future recurring revenue. As such, we will further evolve the focus of our organization towards the delivery of more integrated hardware and software solutions for our customers, as well as related services. While we have invested in software development in the past, we will be expending additional resources in this area in the future, including key new hires. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations and insufficient revenue to offset expenses associated with this strategy. Software

development is inherently risky for a company such as ours with a historically hardware-centric business model, and accordingly, our efforts in software development may not be successful. Any increased investment in software research and development may materially adversely affect our financial condition and operating results.

We may spend a proportionately greater amount on software research and development in the future. If we cannot proportionately decrease our cost structure in response to competitive price pressures, our gross margin and, therefore, our profitability could be adversely affected. In addition, if our software solutions, services, applications, pricing and other factors are not sufficiently competitive, or if there is an adverse reaction to our product decisions, we may lose market share in certain areas, which could adversely affect our revenue and prospects.

Software research and development is complex. We must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. We must accurately forecast mixes of software solutions and configurations that meet customer requirements, and we may not succeed at doing so within a given product's life cycle or at all. Any delay in the development, production or marketing of a new software solution could result in us not being among the first to market, which could further harm our competitive position. In addition, our regular testing and quality control efforts may not be effective in controlling or detecting all quality issues and defects. We may be unable to determine the cause, find an appropriate solution or offer a temporary fix to address defects. Finding solutions to quality issues or defects can be expensive and may result in additional warranty, replacement and other costs, adversely affecting our profits. If new or existing customers have difficulty with our software solutions or are dissatisfied with our services, our operating margins could be adversely affected, and we could face possible claims if we fail to meet our customers' expectations. In addition, quality issues can impair our relationships with new or existing customers and adversely affect our brand and reputation, which could adversely affect our operating results.

***If disruptions in our transportation network occur or our shipping costs substantially increase, we may be unable to sell or timely deliver our products, and our operating expenses could increase.**

We are highly dependent upon the transportation systems we use to ship our products, including surface and air freight. Our attempts to closely match our inventory levels to our product demand intensify the need for our transportation systems to function effectively and without delay. On a quarterly basis, our shipping volume also tends to steadily increase as the quarter progresses, which means that any disruption in our transportation network in the latter half of a quarter will likely have a more material effect on our business than at the beginning of a quarter. For example, as also noted in the risk factor "The COVID-19 pandemic could materially adversely affect our financial condition and results of operations," above, the outbreak of the COVID-19 pandemic has led to significant limitations on the availability of key transportation resources and an increase in the cost of air freight. These developments negatively impact our profitability as we seek to transport an increased number of products from manufacturing locations in Asia to other markets around the world as quickly as possible.

The transportation network is subject to disruption or congestion from a variety of causes, including labor disputes or port strikes, acts of war or terrorism, natural disasters and congestion resulting from higher shipping volumes. Labor disputes among freight carriers and at ports of entry are common, particularly in Europe, and we expect labor unrest and its effects on shipping our products to be a continuing challenge for us. A port worker strike, work slow-down or other transportation disruption in Long Beach, California, where we have a significant distribution center, could significantly disrupt our business. Our international freight is regularly subjected to inspection by governmental entities. If our delivery times increase unexpectedly for these or any other reasons, our ability to deliver products on time would be materially adversely affected and result in delayed or lost revenue as well as customer imposed penalties. In addition, if increases in fuel prices occur, our transportation costs would likely increase. Moreover, the cost of shipping our products by air freight is greater than other methods. From time to time in the past, we have shipped products using extensive air freight to meet unexpected spikes in demand, shifts in demand between product categories, to bring new product introductions to market quickly and to timely ship products previously ordered. If we rely more heavily upon air freight to deliver our products, our overall shipping costs will increase. A prolonged transportation disruption or a significant increase in the cost of freight could severely disrupt our business and harm our operating results.

If we do not effectively manage our sales channel inventory and product mix, we may incur costs associated with excess inventory, or lose sales from having too few products.

If we are unable to properly monitor and manage our sales channel inventory and maintain an appropriate level and mix of products with our wholesale distributors and within our sales channels, we may incur increased and unexpected costs associated with this inventory. We generally allow wholesale distributors and traditional retailers to return a limited amount of our products in exchange for other products. Under our price protection policy, if we reduce the list price of a product, we are often required to issue a credit in an amount equal to the reduction for each of the products held in inventory by our wholesale distributors and retailers. If our wholesale distributors and retailers are unable to sell their inventory in a timely manner, we might lower the price of the products, or these parties may exchange the products for newer products. Also, during the transition from an existing product to a new replacement product, we must accurately predict the demand for the existing and the new product.

We determine production levels based on our forecasts of demand for our products. Actual demand for our products depends on many factors, which makes it difficult to forecast. We have experienced differences between our actual and our forecasted demand in the past and expect differences to arise in the future. If we improperly forecast demand for our products we could end up with too many products and be unable to sell the excess inventory in a timely manner, if at all, or, alternatively we could end up with too few products and not be able to satisfy demand. This problem is exacerbated because we attempt to closely match inventory levels with product demand leaving limited margin for error. If these events occur, we could incur increased expenses associated with writing off excessive or obsolete inventory, lose sales, incur penalties for late delivery or have to ship products by air freight to meet immediate demand incurring incremental freight costs above the sea freight costs, a preferred method, and suffering a corresponding decline in gross margins.

We are exposed to adverse currency exchange rate fluctuations in jurisdictions where we transact in local currency, which could harm our financial results and cash flows.

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our results of operations, financial position and cash flows. Although a portion of our international sales are currently invoiced in United States dollars, we have implemented and continue to implement for certain countries and customers both invoicing and payment in foreign currencies. Our primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar denominated sales in Europe, Japan and Australia as well as our global operations, and non-U.S. dollar denominated operating expenses and certain assets and liabilities. In addition, weaknesses in foreign currencies for U.S. dollar denominated sales could adversely affect demand for our products. Conversely, a strengthening in foreign currencies against the U.S. dollar could increase foreign currency denominated costs. As a result we may attempt to renegotiate pricing of existing contracts or request payment to be made in U.S. dollars. We cannot be sure that our customers would agree to renegotiate along these lines. This could result in customers eventually terminating contracts with us or in our decision to terminate certain contracts, which would adversely affect our sales.

We hedge our exposure to fluctuations in foreign currency exchange rates as a response to the risk of changes in the value of foreign currency-denominated assets and liabilities. We may enter into foreign currency forward contracts or other instruments, the majority of which mature within approximately five months. Our foreign currency forward contracts reduce, but do not eliminate, the impact of currency exchange rate movements. For example, we do not execute forward contracts in all currencies in which we conduct business. In addition, we hedge to reduce the impact of volatile exchange rates on net revenue, gross profit and operating profit for limited periods of time. However, the use of these hedging activities may only offset a portion of the adverse financial effect resulting from unfavorable movements in foreign exchange rates.

If we fail to overcome the challenges associated with managing our broadband service provider sales channel, our net revenue and gross profit will be negatively impacted.

We sell a significant number of products through broadband service providers worldwide. However, the service provider sales channel is challenging and exceptionally competitive. Difficulties and challenges in selling to service providers include a longer sales cycle, more stringent product testing and validation requirements, a higher level of customization demands, requirements that suppliers take on a larger share of the risk with respect to contractual business terms, competition from established suppliers, pricing pressure resulting in lower gross margins, and irregular and

unpredictable ordering habits. For example, rigorous service provider certification processes may delay our sale of new products, or our products ultimately may fail these tests. In either event, we may lose some or all of the amounts we expended in trying to obtain business from the service provider, as well as lose the business opportunity altogether. In addition, even if we have a product which a service provider customer may wish to purchase, we may choose not to supply products to the potential service provider customer if the contract requirements, such as service level requirements, penalties, and liability provisions, are too onerous. Accordingly, our business may be harmed and our revenues may be reduced. We have, in exceptional limited circumstances, while still in contract negotiations, shipped products in advance of and subject to agreement on a definitive contract. We do not record revenue from these shipments until a definitive contract exists. There is risk that we do not ultimately close and sign a definitive contract. If this occurs, the timing of revenue recognition is uncertain and our business would be harmed. In addition, we often commence building custom-made products prior to execution of a contract in order to meet the customer's contemplated launch dates and requirements. Service provider products are generally custom-made for a specific customer and may not be salable to other customers or in other channels. If we have pre-built custom-made products but do not come to agreement on a definitive contract, we may be forced to scrap the custom-made products or re-work them at substantial cost and our business would be harmed.

Further, successful engagements with service provider customers requires a constant analysis of technology trends. If we are unable to anticipate technology trends and service provider customer product needs, and to allocate research and development resources to the right projects, we may not be successful in continuing to sell products to service provider customers. In addition, because our service provider customers command significant resources, including for software support, and demand extremely competitive pricing, certain ODMs have declined to develop service provider products on an ODM basis. Accordingly, as our ODMs increasingly limit development of our service provider products, our service provider business will be harmed if we cannot replace this capability with alternative ODMs or in-house development.

Orders from service providers generally tend to be large but sporadic, which causes our revenues from them to fluctuate and challenges our ability to accurately forecast demand from them. In particular, managing inventory and production of our products for our service provider customers is a challenge. Many of our service provider customers have irregular purchasing requirements. These customers may decide to cancel orders for customized products specific to that customer, and we may not be able to reconfigure and sell those products in other channels. These cancellations could lead to substantial write-offs. In addition, these customers may issue unforecasted orders for products which we may not be able to produce in a timely manner and as such, we may not be able to accept and deliver on such unforecasted orders. In certain cases, we may commit to fixed-price, long term purchase orders, with such orders priced in foreign currencies which could lose value over time in the event of adverse changes in foreign exchange rates. Even if we are selected as a supplier, typically a service provider will also designate a second source supplier, which over time will reduce the aggregate orders that we receive from that service provider. Further, as the technology underlying our products deployed by broadband service providers matures and more competitors offer alternative products with similar technology, we anticipate competing in an extremely price sensitive market and our margins may be affected. If we are unable to introduce new products with sufficiently advanced technology to attract service provider interest in a timely manner, our service provider customers may then require us to lower our prices, or they may choose to purchase products from our competitors. If this occurs, our business would be harmed and our revenues would be reduced.

If we were to lose a service provider customer for any reason, we may experience a material and immediate reduction in forecasted revenue that may cause us to be below our net revenue and operating margin expectations for a particular period of time and therefore adversely affect our stock price. For example, many of our competitors in the service provider space aggressively price their products in order to gain market share. We may not be able to match the lower prices offered by our competitors, and we may choose to forgo lower-margin business opportunities. Many of the service provider customers will seek to purchase from the lowest cost provider, notwithstanding that our products may be higher quality or that our products were previously validated for use on their proprietary network. Accordingly, we may lose customers who have lower, more aggressive pricing, and our revenues may be reduced. In addition, service providers may choose to prioritize the implementation of other technologies or the roll out of other services than home networking. Weakness in orders from this industry could have a material adverse effect on our business, operating results, and financial condition. We have seen slowdowns in capital expenditures by certain of our service provider customers in the past, and believe there may be potential for similar slowdowns in the future. Any slowdown in the general economy, over supply, consolidation among service providers, regulatory developments and constraint on capital expenditures could result in reduced demand from service providers and therefore adversely affect our sales to them. If we do not successfully overcome these challenges, we will not be able to profitably manage our service provider sales channel and our financial results will be harmed.

The average selling prices of our products typically decrease rapidly over the sales cycle of the product, which may negatively affect our net revenue and gross margins.

Our products typically experience price erosion, a fairly rapid reduction in the average unit selling prices over their respective sales cycles. In order to sell products that have a falling average unit selling price and maintain margins at the same time, we need to continually reduce product and manufacturing costs. To manage manufacturing costs, we must collaborate with our third-party manufacturers to engineer the most cost-effective design for our products. In addition, we must carefully manage the price paid for components used in our products. We must also successfully manage our freight and inventory costs to reduce overall product costs. We also need to continually introduce new products with higher sales prices and gross margins in order to maintain our overall gross margins. If we are unable to manage the cost of older products or successfully introduce new products with higher gross margins, our net revenue and overall gross margin would likely decline.

We depend substantially on our sales channels, and our failure to maintain and expand our sales channels would result in lower sales and reduced net revenue.

To maintain and grow our market share, net revenue and brand, we must maintain and expand our sales channels. Our sales channels consist of traditional retailers, online retailers, DMRs, VARs, and broadband service providers. Some of these entities purchase our products through our wholesale distributor customers. We generally have no minimum purchase commitments or long-term contracts with any of these third parties.

Traditional retailers have limited shelf space and promotional budgets, and competition is intense for these resources. If the networking sector does not experience sufficient growth, retailers may choose to allocate more shelf space to other consumer product sectors. A competitor with more extensive product lines and stronger brand identity may have greater bargaining power with these retailers. Any reduction in available shelf space or increased competition for such shelf space would require us to increase our marketing expenditures simply to maintain current levels of retail shelf space, which would harm our operating margin. Our traditional retail customers have faced increased and significant competition from online retailers. If we cannot effectively manage our business amongst our online customers and traditional retail customers, our business would be harmed. The recent trend in the consolidation of online retailers and DMR channels has resulted in intensified competition for preferred product placement, such as product placement on an online retailer's Internet home page. Expanding our presence in the VAR channel may be difficult and expensive. We compete with established companies that have longer operating histories and longstanding relationships with VARs that we would find highly desirable as sales channel partners. In addition, our efforts to realign or consolidate our sales channels may cause temporary disruptions in our product sales and revenue, and these changes may not result in the expected longer-term benefits.

We also sell products to broadband service providers. Competition for selling to broadband service providers is fierce and intense. Penetrating service provider accounts typically involves a long sales cycle and the challenge of displacing incumbent suppliers with established relationships and field-deployed products. If we are unable to maintain and expand our sales channels, our growth would be limited and our business would be harmed.

We must also continuously monitor and evaluate emerging sales channels. If we fail to establish a presence in an important developing sales channel, our business could be harmed.

If we lose the services of our Chairman and Chief Executive Officer, Patrick C.S. Lo, or our other key personnel, we may not be able to execute our business strategy effectively.

Our future success depends in large part upon the continued services of our key technical, engineering, sales, marketing, finance and senior management personnel. In particular, the services of Patrick C.S. Lo, our Chairman and Chief Executive Officer, who has led our company since its inception, are very important to our business. We do not maintain any key person life insurance policies. Our business model requires extremely skilled and experienced senior management who are able to withstand the rigorous requirements and expectations of our business. Our success depends on senior management being able to execute at a very high level. The loss of any of our senior management or other key engineering, research, development, sales or marketing personnel, particularly if lost to competitors, could harm our ability to implement our business strategy and respond to the rapidly changing needs of our business. While we have adopted an

emergency succession plan for the short term, we have not formally adopted a long-term succession plan. As a result, if we suffer the loss of services of any key executive, our long-term business results may be harmed. While we believe that we have mitigated some of the business execution and business continuity risk with our organization into two business segments with separate leadership teams, the loss of any key personnel would still be disruptive and harm our business, especially given that our business is leanly staffed and relies on the expertise and high performance of our key personnel. In addition, because we do not have a formal long-term succession plan, we may not be able to have the proper personnel in place to effectively execute our long term business strategy if Mr. Lo or other key personnel retire, resign or are otherwise terminated.

***Changes in tax laws or exposure to additional income tax liabilities could affect our future profitability.**

Factors that could materially affect our future effective tax rates include but are not limited to:

- changes in tax laws or the regulatory environment;
- changes in accounting and tax standards or practices;
- changes in the composition of operating income by tax jurisdiction; and
- our operating results before taxes.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective tax rate has fluctuated in the past and may fluctuate in the future. Future effective tax rates could be affected by changes in the composition of earnings in countries with differing tax rates, changes in deferred tax assets and liabilities, or changes in tax laws. Foreign jurisdictions have increased the volume of tax audits of multinational corporations. Further, many countries, have either changed or are considering changes to their tax laws. These changes are largely punitive to U.S. multinational corporations. Changes in tax laws could affect the distribution of our earnings, result in double taxation and adversely affect our results. On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law making significant changes to the Internal Revenue Code. In particular, sweeping changes were made to the U.S. taxation of foreign operations. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, the transition of U.S. international taxation from a worldwide tax system to a quasi-territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings. Additionally, new provisions were added to mitigate the potential erosion of the U.S. tax base and to discourage use of low tax jurisdictions to own intellectual property and other valuable intangible assets. The Company completed its analysis of the impact of the Tax Act and has finalized all estimates previously considered provisional under Staff Accounting Bulletin 118 in the fourth quarter of 2018. The changes in tax law under the Tax Act are complex and regulations governing the implementation continue to be issued. While the Company believes it has correctly accounted for the impact of the Tax Act, guidance continues to be issued and may differ from our interpretation based on existing facts and circumstances.

In addition to the impact of the Tax Act on our federal taxes, the Tax Act may impact our taxation in other jurisdictions, including with respect to state income taxes. Additionally, other foreign governing bodies may enact changes in their tax laws in reaction to the Tax Act that could result in changes in our global tax position and materially affect our financial position.

We have been audited by the Italian Tax Authority (ITA) for the 2004 through 2012 tax years. The ITA examination included an audit of income, gross receipts and value-added taxes. Currently, we are in litigation with the ITA for the 2004 through 2012 years. If we are unsuccessful in defending our tax positions, our profitability will be reduced.

We are also subject to examination by other tax authorities, including state revenue agencies and other foreign governments. While we regularly assess the likelihood of favorable or unfavorable outcomes resulting from examinations by the IRS and other tax authorities to determine the adequacy of our provision for income taxes, there can be no assurance that the actual outcome resulting from these examinations will not materially adversely affect our financial condition and operating results. Additionally, the IRS and several foreign tax authorities have increasingly focused attention on intercompany transfer pricing with respect to sales of products and services and the use of intangibles. Tax authorities could disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. We have been notified by the IRS in a letter dated July 13, 2020 that they will audit the Company's U.S. federal tax return and payroll taxes for our fiscal year ended December 31, 2018. If we do not prevail in any such disagreements, our profitability may be affected.

Our separation from Arlo and the distribution of Arlo shares to our stockholders may not achieve some or all of the anticipated benefits and may adversely affect our business.

On February 6, 2018, we announced that our Board of Directors had unanimously approved the pursuit of a separation of our smart camera business "Arlo" from NETGEAR (the "Separation"), to be effected by way of initial public offering ("IPO") and spin-off. On August 7, 2018, Arlo Technologies, Inc. ("Arlo") completed its IPO and generated proceeds of approximately \$170.2 million, net of offering costs. Upon completion of the IPO, we held 62,500,000 shares of Arlo common stock, representing approximately 84.2% of the outstanding shares of Arlo common stock. On December 31, 2018, we completed the distribution of these 62,500,000 shares to our stockholders (the "Distribution"), and we no longer own any shares of Arlo common stock after the Distribution.

There is a risk that we may not be able to achieve the full strategic, operational and financial benefits to us and Arlo that were anticipated to result from the Separation or that such benefits may be delayed or not occur at all. In fact, the Distribution may adversely affect our business. Following the Distribution, we are a smaller company with a less diversified product portfolio and a narrower business focus. As a result, we may be more vulnerable to changing market conditions, which could materially and adversely affect our business, financial condition and results of operations. Although NETGEAR and Arlo are now two independent companies, our long joint history may cause consumers and investors to continue to associate the companies with each other, either positively or negatively.

We could incur significant liability if the Distribution is determined to be a taxable transaction.

We have received an opinion from outside tax counsel to the effect that the Distribution qualifies as a transaction that is generally tax-free for U.S. federal income tax purposes. The opinion relies on certain facts, assumptions, representations and undertakings from Arlo and us regarding the past and future conduct of the companies' respective businesses and other matters. If any of these facts, assumptions, representations or undertakings are incorrect or not satisfied, our stockholders and we may not be able to rely on the opinion of tax counsel and could be subject to significant tax liabilities. Notwithstanding the opinion of tax counsel we have received, the IRS could determine on audit that the Distribution is taxable if it determines that any of these facts, assumptions, representations or undertakings are not correct or have been violated or if it disagrees with the conclusions in the opinion. If the Distribution were determined to be taxable for U.S. federal income tax purposes, in general, we would recognize taxable gain as if we had sold Arlo common stock in a taxable sale for its fair market value, and our stockholders who received shares of Arlo common stock in the Distribution would be subject to tax as if they had received a taxable distribution equal to the fair market value of such shares.

We may be exposed to claims and liabilities as a result of the Distribution.

We entered into a separation agreement and various other agreements with Arlo to govern the Distribution and the relationship of the two companies going forward. These agreements provide for specific indemnity and liability obligations and could lead to disputes between us and Arlo. The indemnity rights we have against Arlo under the agreements may not be sufficient to protect us, for example if our losses exceeded our indemnity rights or if Arlo did not have the financial resources to meet its indemnity obligations. In addition, our indemnity obligations to Arlo may be significant, and these risks could negatively affect our results of operations and financial condition.

***Our sales and operations in international markets expose us to operational, financial and regulatory risks.**

International sales comprise a significant amount of our overall net revenue. International sales were approximately 29% of overall net revenue in the second quarter of fiscal 2020 and approximately 36% of overall net revenue in fiscal 2019. We continue to be committed to growing our international sales, and while we have committed resources to expanding our international operations and sales channels, these efforts may not be successful. International operations are subject to a number of other risks, including:

- exchange rate fluctuations;
- political and economic instability, international terrorism and anti-American sentiment, particularly in emerging markets;
- potential for violations of anti-corruption laws and regulations, such as those related to bribery and fraud;
- preference for locally branded products, and laws and business practices favoring local competition;
- changes in local tax and customs duty laws or changes in the enforcement, application or interpretation of such laws (including potential responses to the higher tariffs on certain imported products announced by the current U.S. administration);
- consequences of, and uncertainty related to, the "BREXIT" process by the United Kingdom and the current transition, which could lead to additional expense and complexity in doing business there;
- increased difficulty in managing inventory;
- delayed revenue recognition;
- less effective protection of intellectual property;
- stringent consumer protection and product compliance regulations, including but not limited to the Restriction of Hazardous Substances directive, the Waste Electrical and Electronic Equipment directive and the European Ecodesign directive, or EuP, that are costly to comply with and may vary from country to country;
- difficulties and costs of staffing and managing foreign operations; and
- business difficulties, including potential bankruptcy or liquidation, of any of our worldwide third party logistics providers.

While we believe we generally have good relations with our employees, employees in certain jurisdictions have rights which give them certain collective rights. If management must expend significant resources and effort to address and comply with these rights, our business may be harmed. We are also required to comply with local environmental legislation and our customers rely on this compliance in order to sell our products. If our customers do not agree with our interpretations and requirements of new legislation, they may cease to order our products and our revenue would be harmed.

We must comply with indirect tax laws in multiple jurisdictions, as well as complex customs duty regimes worldwide. Audits of our compliance with these rules may result in additional liabilities for taxes, duties, interest and penalties related to our international operations which would reduce our profitability.

Our operations are routinely subject to audit by tax authorities in various countries. Many countries have indirect tax systems where the sale and purchase of goods and services are subject to tax based on the transaction value. These taxes are commonly referred to as sales and/or use tax, value-added tax (VAT) or goods and services tax (GST). In addition, the distribution of our products subjects us to numerous complex customs regulations, which frequently change over time.

Failure to comply with these systems and regulations can result in the assessment of additional taxes, duties, interest and penalties. While we believe we are in compliance with local laws, we cannot assure that tax and customs authorities would agree with our reporting positions and upon audit may assess us additional taxes, duties, interest and penalties.

Additionally, some of our products are subject to U.S. export controls, including the Export Administration Regulations and economic sanctions administered by the Office of Foreign Assets Control. We also incorporate encryption technology into certain of our solutions. These encryption solutions and underlying technology may be exported outside of the United States only with the required export authorizations or exceptions, including by license, a license exception, appropriate classification notification requirement and encryption authorization.

Furthermore, our activities are subject to U.S. economic sanctions laws and regulations that prohibit the shipment of certain products and services without the required export authorizations, including to countries, governments and persons targeted by U.S. embargoes or sanctions. Additionally, the current U.S. administration has been critical of existing trade agreements and may impose more stringent export and import controls. Obtaining the necessary export license or other authorization for a particular sale may be time consuming, and may result in delay or loss of sales opportunities even if the export license ultimately is granted. While we take precautions to prevent our solutions from being exported in violation of these laws, including using authorizations or exceptions for our encryption products and implementing IP address blocking and screenings against U.S. government and international lists of restricted and prohibited persons and countries, we have not been able to guarantee, and cannot guarantee that the precautions we take will prevent all violations of export control and sanctions laws, including if purchasers of our products bring our products and services into sanctioned countries without our knowledge. Violations of U.S. sanctions or export control laws can result in significant fines or penalties and incarceration could be imposed on employees and managers for criminal violations of these laws.

Also, various countries, in addition to the United States, regulate the import and export of certain encryption and other technology, including import and export licensing requirements, and have enacted laws that could limit our ability to distribute our products and services or our end-users' ability to utilize our solutions in their countries. Changes in our products and services or changes in import and export regulations may create delays in the introduction of our products in international markets.

Adverse action by any government agencies related to indirect tax laws could materially adversely affect our business, operating results and financial condition.

If our products contain defects or errors, we could incur significant unexpected expenses, experience product returns and lost sales, experience product recalls, suffer damage to our brand and reputation, and be subject to product liability or other claims.

Our products are complex and may contain defects, errors or failures, particularly when first introduced or when new versions are released. The industry standards upon which many of our products are based are also complex, experience change over time and may be interpreted in different manners. Some errors and defects may be discovered only after a product has been installed and used by the end-user.

In addition, epidemic failure clauses are found in certain of our customer contracts, especially contracts with service providers. If invoked, these clauses may entitle the customer to return for replacement or obtain credits for products and inventory, as well as assess liquidated damage penalties and terminate an existing contract and cancel future or then current purchase orders. In such instances, we may also be obligated to cover significant costs incurred by the customer associated with the consequences of such epidemic failure, including freight and transportation required for product replacement and out-of-pocket costs for truck rolls to end user sites to collect the defective products. Costs or payments we make in connection with an epidemic failure may materially adversely affect our results of operations and financial condition. If our products contain defects or errors, or are found to be noncompliant with industry standards, we could experience decreased sales and increased product returns, loss of customers and market share, and increased service, warranty and insurance costs. In addition, defects in, or misuse of, certain of our products could cause safety concerns, including the risk of property damage or personal injury. If any of these events occurred, our reputation and brand could be damaged, and we could face product liability or other claims regarding our products, resulting in unexpected expenses and adversely impacting our operating results. For instance, if a third party were able to successfully overcome the security measures in

our products, such a person or entity could misappropriate customer data, third party data stored by our customers and other information, including intellectual property. In addition, the operations of our end-user customers may be interrupted. If that happens, affected end-users or others may file actions against us alleging product liability, tort, or breach of warranty claims.

***Political events, war, terrorism, public health issues, natural disasters, sudden changes in trade and immigration policies, and other circumstances could materially adversely affect us.**

Our corporate headquarters are located in Northern California and one of our warehouses is located in Southern California, both of which are regions known for seismic activity. Substantially all of our critical enterprise-wide information technology systems, including our main servers, are currently housed in colocation facilities in Mesa, Arizona. While our critical information technology systems are located at colocation facilities in a different geographic region in the United States, our headquarters and warehouses remain susceptible to seismic activity so long as they are located in California. In addition, the majority of our manufacturing occurs in Southeast Asia and mainland China, where disruptions from natural disasters, health epidemics and political, social and economic instability may affect the region. If our manufacturers or warehousing facilities are disrupted or destroyed, we would be unable to distribute our products on a timely basis, which could harm our business.

In addition, war, terrorism, geopolitical uncertainties, public health issues, sudden changes in trade and immigration policies (such as the higher tariffs on certain products imported from China enacted by the current U.S. administration), and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on us, our suppliers, logistics providers, manufacturing vendors and customers. Our business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, public health issues, and other events beyond our control, including the COVID-19 pandemic discussed further in the risk factor “The COVID-19 pandemic could materially adversely affect our financial condition and results of operations,” above. In addition, in the past, labor disputes at third-party manufacturing facilities have led to workers going on strike, and labor unrest could materially affect our third-party manufacturers' abilities to manufacture our products.

Such events could decrease demand for our products, make it difficult, more expensive or impossible for us to make and deliver products to our customers or to receive components from our direct or indirect suppliers, and create delays and inefficiencies in our supply chain. Major public health issues, including pandemics such as COVID-19, could negatively affect us through more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of our manufacturing vendors and component suppliers.

We are currently involved in numerous litigation matters in the ordinary course and may in the future become involved in additional litigation, including litigation regarding intellectual property rights, consumer class actions and securities class actions, any of which could be costly and subject us to significant liability.

The networking industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding infringement of patents, trade secrets and other intellectual property rights. In particular, leading companies in the data communications markets, some of which are our competitors, have extensive patent portfolios with respect to networking technology. From time to time, third parties, including these leading companies, have asserted and may continue to assert exclusive patent, copyright, trademark and other intellectual property rights against us demanding license or royalty payments or seeking payment for damages, injunctive relief and other available legal remedies through litigation. These also include third-party non-practicing entities who claim to own patents or other intellectual property that cover industry standards that our products comply with. If we are unable to resolve these matters or obtain licenses on acceptable or commercially reasonable terms, we could be sued or we may be forced to initiate litigation to protect our rights. The cost of any necessary licenses could significantly harm our business, operating results and financial condition. We may also choose to join defensive patent aggregation services in order to prevent or settle litigation against such non-practicing entities and avoid the associated significant costs and uncertainties of litigation. These patent aggregation services may obtain, or have previously obtained, licenses for the alleged patent infringement claims against us and other patent assets that could be used offensively against us. The costs of such defensive patent aggregation services, while potentially lower than the costs of litigation, may be significant as well. At any time, any of these non-practicing entities, or any other third-party could initiate litigation against us, or we may be forced to initiate litigation against them, which could

divert management attention, be costly to defend or prosecute, prevent us from using or selling the challenged technology, require us to design around the challenged technology and cause the price of our stock to decline. In addition, third parties, some of whom are potential competitors, have initiated and may continue to initiate litigation against our manufacturers, suppliers, members of our sales channels or our service provider customers or even end user customers, alleging infringement of their proprietary rights with respect to existing or future products. In the event successful claims of infringement are brought by third parties, and we are unable to obtain licenses or independently develop alternative technology on a timely basis, we may be subject to indemnification obligations, be unable to offer competitive products, or be subject to increased expenses. Consumer class-action lawsuits related to the marketing and performance of our home networking products have been asserted and may in the future be asserted against us. Finally, along with Arlo Technologies and individuals and underwriters involved in Arlo's initial public offering, we have been sued in securities class action lawsuits, and may in the future be named in other similar lawsuits. For additional information regarding certain of the lawsuits in which we are involved, see the information set forth in Note 8. Commitments and Contingencies, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

As part of growing our business, we have made and expect to continue to make acquisitions. If we fail to successfully select, execute or integrate our acquisitions, then our business and operating results could be harmed and our stock price could decline.

From time to time, we will undertake acquisitions to add new product lines and technologies, gain new sales channels or enter into new sales territories. For example, in August 2018, we acquired Meural Inc., a leader in digital platforms for visual art, to enhance our Connected Home product and service offerings. Acquisitions involve numerous risks and challenges, including but not limited to the following:

- integrating the companies, assets, systems, products, sales channels and personnel that we acquire;
- higher than anticipated acquisition and integration costs and expenses;
- reliance on third parties to provide transition services for a period of time after closing to ensure an orderly transition of the business;
- growing or maintaining revenues to justify the purchase price and the increased expenses associated with acquisitions;
- entering into territories or markets with which we have limited or no prior experience;
- establishing or maintaining business relationships with customers, vendors and suppliers who may be new to us;
- overcoming the employee, customer, vendor and supplier turnover that may occur as a result of the acquisition;
- disruption of, and demands on, our ongoing business as a result of integration activities including diversion of management's time and attention from running the day to day operations of our business;
- inability to implement uniform standards, disclosure controls and procedures, internal controls over financial reporting and other procedures and policies in a timely manner;
- inability to realize the anticipated benefits of or successfully integrate with our existing business the businesses, products, technologies or personnel that we acquire; and
- potential post-closing disputes.

As part of undertaking an acquisition, we may also significantly revise our capital structure or operational budget, such as issuing common stock that would dilute the ownership percentage of our stockholders, assuming liabilities or debt, utilizing a substantial portion of our cash resources to pay for the acquisition or significantly increasing operating expenses. Our acquisitions have resulted and may in the future result in charges being taken in an individual quarter as well as future

periods, which results in variability in our quarterly earnings. In addition, our effective tax rate in any particular quarter may also be impacted by acquisitions. Following the closing of an acquisition, we may also have disputes with the seller regarding contractual requirements and covenants. Any such disputes may be time consuming and distract management from other aspects of our business. In addition, if we increase the pace or size of acquisitions, we will have to expend significant management time and effort into the transactions and the integrations and we may not have the proper human resources bandwidth to ensure successful integrations and accordingly, our business could be harmed.

As part of the terms of acquisition, we may commit to pay additional contingent consideration if certain revenue or other performance milestones are met. We are required to evaluate the fair value of such commitments at each reporting date and adjust the amount recorded if there are changes to the fair value.

We cannot ensure that we will be successful in selecting, executing and integrating acquisitions. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results. In addition, if stock market analysts or our stockholders do not support or believe in the value of the acquisitions that we choose to undertake, our stock price may decline.

***We invest in companies for both strategic and financial reasons, but may not realize a return on our investments.**

We have made, and continue to seek to make, investments in companies around the world to further our strategic objectives and support our key business initiatives. These investments may include equity or debt instruments of public or private companies, and may be non-marketable at the time of our initial investment. We do not restrict the types of companies in which we seek to invest. These companies may range from early-stage companies that are often still defining their strategic direction to more mature companies with established revenue streams and business models. If any company in which we invest fails, we could lose all or part of our investment in that company. If we determine that an other-than-temporary decline in the fair value exists for an equity or debt investment in a public or private company in which we have invested, we will have to write down the investment to its fair value and recognize the related write-down as an investment loss. The performance of any of these investments could result in significant impairment charges and gains (losses) on other equity investments. For example, during the first quarter of 2020, we recognized an impairment charge of \$4.5 million brought about by triggering events impacting the valuation of a number of our privately held long-term investments, partially due to the onset of the COVID-19 pandemic. We must also analyze accounting and legal issues when making these investments. If we do not structure these investments properly, we may be subject to certain adverse accounting issues, such as potential consolidation of financial results.

Furthermore, if the strategic objectives of an investment have been achieved, or if the investment or business diverges from our strategic objectives, we may seek to dispose of the investment. Our non-marketable equity investments in private companies are not liquid, and we may not be able to dispose of these investments on favorable terms or at all. The occurrence of any of these events could harm our results. Gains or losses from equity securities could vary from expectations depending on gains or losses realized on the sale or exchange of securities and impairment charges related to debt instruments as well as equity and other investments.

We are subject to, and must remain in compliance with, numerous laws and governmental regulations concerning the manufacturing, use, distribution and sale of our products, as well as any such future laws and regulations. Some of our customers also require that we comply with their own unique requirements relating to these matters. Any failure to comply with such laws, regulations and requirements, and any associated unanticipated costs, may adversely affect our business, financial condition and results of operations.

We manufacture and sell products which contain electronic components, and such components may contain materials that are subject to government regulation in both the locations that we manufacture and assemble our products, as well as the locations where we sell our products. For example, certain regulations limit the use of lead in electronic components. To our knowledge, we maintain compliance with all applicable current government regulations concerning the materials utilized in our products, for all the locations in which we operate. Since we operate on a global basis, this is a complex process which requires continual monitoring of regulations and an ongoing compliance process to ensure that we and our suppliers are in compliance with all existing regulations. There are areas where new regulations have been enacted which could increase our cost of the components that we utilize or require us to expend additional resources to ensure compliance. For example, the SEC's "conflict minerals" rules apply to our business, and we are expending significant resources to ensure compliance. The implementation of these requirements by government regulators and our partners and/or customers could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of certain components

used in our products. In addition, the supply-chain due diligence investigation required by the conflict minerals rules will require expenditures of resources and management attention regardless of the results of the investigation. If there is an unanticipated new regulation which significantly impacts our use of various components or requires more expensive components, that regulation would have a material adverse impact on our business, financial condition and results of operations.

One area which has a large number of regulations is the environmental compliance. Management of environmental pollution and climate change has produced significant legislative and regulatory efforts on a global basis, and we believe this will continue both in scope and the number of countries participating. These changes could directly increase the cost of energy which may have an impact on the way we manufacture products or utilize energy to produce our products. In addition, any new regulations or laws in the environmental area might increase the cost of raw materials we use in our products. Environmental regulations require us to reduce product energy usage, monitor and exclude an expanding list of restricted substances and to participate in required recover and recycling of our products. While future changes in regulations are certain, we are currently unable to predict how any such changes will impact us and if such impacts will be material to our business. If there is a new law or regulation that significantly increases our costs of manufacturing or causes us to significantly alter the way that we manufacture our products, this would have a material adverse effect on our business, financial condition and results of operations.

Our selling and distribution practices are also regulated in large part by U.S. federal and state as well as foreign antitrust and competition laws and regulations. In general, the objective of these laws is to promote and maintain free competition by prohibiting certain forms of conduct that tend to restrict production, raise prices, or otherwise control the market for goods or services to the detriment of consumers of those goods and services. Potentially prohibited activities under these laws may include unilateral conduct, or conduct undertaken as the result of an agreement with one or more of our suppliers, competitors, or customers. The potential for liability under these laws can be difficult to predict as it often depends on a finding that the challenged conduct resulted in harm to competition, such as higher prices, restricted supply, or a reduction in the quality or variety of products available to consumers. We utilize a number of different distribution channels to deliver our products to the end consumer, and regularly enter agreements with resellers of our products at various levels in the distribution chain that could be subject to scrutiny under these laws in the event of private litigation or an investigation by a governmental competition authority. In addition, many of our products are sold to consumers via the Internet. Many of the competition-related laws that govern these Internet sales were adopted prior to the advent of the Internet, and, as a result, do not contemplate or address the unique issues raised by online sales. New interpretations of existing laws and regulations, whether by courts or by the state, federal or foreign governmental authorities charged with the enforcement of those laws and regulations, may also impact our business in ways we are currently unable to predict. Any failure on our part or on the part of our employees, agents, distributors or other business partners to comply with the laws and regulations governing competition can result in negative publicity and diversion of management time and effort and may subject us to significant litigation liabilities and other penalties.

In addition to government regulations, many of our customers require us to comply with their own requirements regarding manufacturing, health and safety matters, corporate social responsibility, employee treatment, anti-corruption, use of materials and environmental concerns. Some customers may require us to periodically report on compliance with their unique requirements, and some customers reserve the right to audit our business for compliance. We are increasingly subject to requests for compliance with these customer requirements. For example, there has been significant focus from our customers as well as the press regarding corporate social responsibility policies. Recently, a number of jurisdictions have adopted public disclosure requirements on related topics, including labor practices and policies within companies' supply chains. We regularly audit our manufacturers; however, any deficiencies in compliance by our manufacturers may harm our business and our brand. In addition, we may not have the resources to maintain compliance with these customer requirements and failure to comply may result in decreased sales to these customers, which may have a material adverse effect on our business, financial condition and results of operations.

We are exposed to the credit risk of some of our customers and to credit exposures in weakened markets, which could result in material losses.

A substantial portion of our sales are on an open credit basis, with typical payment terms of 30 to 60 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor

individual customer financial viability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts.

In the past, there have been bankruptcies amongst our customer base, and certain of our customers' businesses face financial challenges that put them at risk of future bankruptcies. Although losses resulting from customer bankruptcies have not been material to date, any future bankruptcies could harm our business and have a material adverse effect on our operating results and financial condition. To the degree that turmoil in the credit markets makes it more difficult for some customers to obtain financing, our customers' ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business, operating results, and financial condition.

If our goodwill or intangible assets become impaired we may be required to record a significant charge to earnings.

Under generally accepted accounting principles, we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered when determining if the carrying value of our goodwill or intangible assets may not be recoverable include a significant decline in our expected future cash flows or a sustained, significant decline in our stock price and market capitalization.

As a result of our acquisitions, we have significant goodwill and intangible assets recorded on our balance sheets. In addition, significant negative industry or economic trends, such as those that have occurred as a result of the recent economic downturn, including reduced estimates of future cash flows or disruptions to our business could indicate that goodwill or intangible assets might be impaired. If, in any period our stock price decreases to the point where our market capitalization is less than our book value, this too could indicate a potential impairment and we may be required to record an impairment charge in that period. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on projections of future operating performance. The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results and market conditions. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit. We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from actual results. As a result, we may incur substantial impairment charges to earnings in our financial statements should an impairment of our goodwill or intangible assets be determined resulting in an adverse impact on our results of operations.

We are required to evaluate our internal controls under Section 404 of the Sarbanes-Oxley Act of 2002 and any adverse results from such evaluation, including restatements of our issued financial statements, could impact investor confidence in the reliability of our internal controls over financial reporting.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to furnish a report by our management on our internal control over financial reporting. Such report must contain among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. From time to time, we conduct internal investigations as a result of whistleblower complaints. In some instances, the whistleblower complaint may implicate potential areas of weakness in our internal controls. Although all known material weaknesses have been remediated, we cannot be certain that the measures we have taken ensure that restatements will not occur in the future. Execution of restatements create a significant strain on our internal resources and could cause delays in our filing of quarterly or annual financial results, increase our costs and cause management distraction. Restatements may also significantly affect our stock price in an adverse manner.

Continued performance of the system and process documentation and evaluation needed to comply with Section 404 is both costly and challenging. During this process, if our management identifies one or more material weaknesses in our internal control over financial reporting, we will be unable to assert such internal control is effective. If we are unable to assert that our internal control over financial reporting is effective as of the end of a fiscal year or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal control over financial

reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which may have an adverse effect on our stock price.

Expansion of our operations and infrastructure may strain our operations and increase our operating expenses.

We have expanded our operations and are pursuing market opportunities both domestically and internationally in order to grow our sales. This expansion has required enhancements to our existing management information systems, and operational and financial controls. In addition, if we continue to grow, our expenditures would likely be significantly higher than our historical costs. We may not be able to install adequate controls in an efficient and timely manner as our business grows, and our current systems may not be adequate to support our future operations. The difficulties associated with installing and implementing new systems, procedures and controls may place a significant burden on our management, operational and financial resources. In addition, if we grow internationally, we will have to expand and enhance our communications infrastructure. If we fail to continue to improve our management information systems, procedures and financial controls or encounter unexpected difficulties during expansion and reorganization, our business could be harmed.

For example, we have invested, and will continue to invest, significant capital and human resources in the design and enhancement of our financial and enterprise resource planning systems, which may be disruptive to our underlying business. We depend on these systems in order to timely and accurately process and report key components of our results of operations, financial position and cash flows. If the systems fail to operate appropriately or we experience any disruptions or delays in enhancing their functionality to meet current business requirements, our ability to fulfill customer orders, bill and track our customers, fulfill contractual obligations, accurately report our financials and otherwise run our business could be adversely affected. Even if we do not encounter these adverse effects, the enhancement of systems may be much more costly than we anticipated. If we are unable to continue to enhance our information technology systems as planned, our financial position, results of operations and cash flows could be negatively impacted.

We rely upon third parties for technology that is critical to our products, and if we are unable to continue to use this technology and future technology, our ability to develop, sell, maintain and support technologically innovative products would be limited.

We rely on third parties to obtain non-exclusive patented hardware and software license rights in technologies that are incorporated into and necessary for the operation and functionality of most of our products. In these cases, because the intellectual property we license is available from third parties, barriers to entry into certain markets may be lower for potential or existing competitors than if we owned exclusive rights to the technology that we license and use. Moreover, if a competitor or potential competitor enters into an exclusive arrangement with any of our key third-party technology providers, or if any of these providers unilaterally decide not to do business with us for any reason, our ability to develop and sell products containing that technology would be severely limited. If we are shipping products that contain third-party technology that we subsequently lose the right to license, then we will not be able to continue to offer or support those products. In addition, these licenses often require royalty payments or other consideration to the third party licensor. Our success will depend, in part, on our continued ability to access these technologies, and we do not know whether these third-party technologies will continue to be licensed to us on commercially acceptable terms, if at all. If we are unable to license the necessary technology, we may be forced to acquire or develop alternative technology of lower quality or performance standards, which would limit and delay our ability to offer new or competitive products and increase our costs of production. As a result, our margins, market share, and operating results could be significantly harmed.

We also utilize third-party software development companies to develop, customize, maintain and support software that is incorporated into our products. If these companies fail to timely deliver or continuously maintain and support the software, as we require of them, we may experience delays in releasing new products or difficulties with supporting existing products and customers. In addition, if these third-party licensors fail or experience instability, then we may be unable to continue to sell products that incorporate the licensed technologies in addition to being unable to continue to maintain and support these products. We do require escrow arrangements with respect to certain third-party software which entitle us to certain limited rights to the source code, in the event of certain failures by the third party, in order to maintain and support such software. However, there is no guarantee that we would be able to fully understand and use the source code, as we may not have the expertise to do so. We are increasingly exposed to these risks as we continue to develop and market more products containing third-party software, such as our TV connectivity, security and network attached storage products. If we are unable to license the necessary technology, we may be forced to acquire or develop alternative technology, which could be of lower quality or performance standards. The acquisition or development of alternative

technology may limit and delay our ability to offer new or competitive products and services and increase our costs of production. As a result, our business, operating results and financial condition could be materially adversely affected.

If we are unable to secure and protect our intellectual property rights, our ability to compete could be harmed.

We rely upon third parties for a substantial portion of the intellectual property that we use in our products. At the same time, we rely on a combination of copyright, trademark, patent and trade secret laws, nondisclosure agreements with employees, consultants and suppliers and other contractual provisions to establish, maintain and protect our intellectual property rights and technology. Despite efforts to protect our intellectual property, unauthorized third parties may attempt to design around, copy aspects of our product design or obtain and use technology or other intellectual property associated with our products. For example, one of our primary intellectual property assets is the NETGEAR name, trademark and logo. We may be unable to stop third parties from adopting similar names, trademarks and logos, particularly in those international markets where our intellectual property rights may be less protected. Furthermore, our competitors may independently develop similar technology or design around our intellectual property. In addition, we manufacture and sell our products in many international jurisdictions that offer reduced levels of protection and recourse from intellectual property misuse or theft, as compared to the United States. Our inability to secure and protect our intellectual property rights could significantly harm our brand and business, operating results and financial condition.

Governmental regulations of imports or exports affecting Internet security could affect our net revenue.

Any additional governmental regulation of imports or exports or failure to obtain required export approval of our encryption technologies could adversely affect our international and domestic sales. The United States and various foreign governments have imposed controls, export license requirements, and restrictions on the import or export of some technologies, particularly encryption technology. In addition, from time to time, governmental agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. In response to terrorist activity, governments could enact additional regulation or restriction on the use, import, or export of encryption technology. This additional regulation of encryption technology could delay or prevent the acceptance and use of encryption products and public networks for secure communications, resulting in decreased demand for our products and services. In addition, some foreign competitors are subject to less stringent controls on exporting their encryption technologies. As a result, they may be able to compete more effectively than we can in the United States and the international Internet security market.

We are exposed to credit risk and fluctuations in the market values of our investment portfolio.

Although we have not recognized any material losses on our cash equivalents and short-term investments, future declines in their market values could have a material adverse effect on our financial condition and operating results. Given the global nature of our business, we have investments with both domestic and international financial institutions. Accordingly, we face exposure to fluctuations in interest rates, which may limit our investment income. If these financial institutions default on their obligations or their credit ratings are negatively impacted by liquidity issues, credit deterioration or losses, financial results, or other factors, the value of our cash equivalents and short-term investments could decline and result in a material impairment, which could have a material adverse effect on our financial condition and operating results.

***Our stock price may be volatile and your investment in our common stock could suffer a decline in value.**

There has been significant volatility in the market price and trading volume of securities of technology and other companies, which may be unrelated to the financial performance of these companies. These broad market fluctuations may negatively affect the market price of our common stock.

Some specific factors that may have a significant effect on our common stock market price include:

- actual or anticipated fluctuations in our operating results or our competitors' operating results;

- actual or anticipated changes in the growth rate of the general networking sector, our growth rates or our competitors' growth rates;
- conditions in the financial markets in general or changes in general economic conditions, including government efforts to mitigate the severe economic downturn resulting from the COVID-19 pandemic;
- actual or anticipated changes in governmental regulation, including taxation and tariff policies;
- interest rate or currency exchange rate fluctuations;
- our ability to forecast or report accurate financial results; and
- changes in stock market analyst recommendations regarding our common stock, other comparable companies or our industry generally.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

- (a) None.
- (b) None.
- (c) Repurchase of Equity Securities by the Company

Period	Total Number of Shares Purchased ⁽²⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
March 30, 2020 - April 26, 2020	339,263	\$ 23.71	315,405	2,679,493
April 27, 2020 - May 24, 2020	62,643	\$ 23.98	—	2,679,493
May 25, 2020 - June 28, 2020	8,666	\$ 24.71	—	2,679,493
Total	<u>410,572</u>	\$ 23.77	<u>315,405</u>	

- (1) From time to time, our Board of Directors has authorized programs under which we may repurchase shares of our common stock, depending on market conditions, in the open market or through privately negotiated transactions. During the three months ended June 28, 2020, we repurchased and retired, reported based on the trade date, approximately shares of 0.3 million common stock at a cost of \$7.5 million under the authorizations.
- (2) During the three months ended June 28, 2020, we repurchased, as reported based on trade date, approximately 95,000 shares of common stock at a cost of \$2.3 million to facilitate tax withholding for RSUs.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

None.

Item 6. Exhibits
Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
3.1	Amended and Restated Certificate of Incorporation of the registrant	10-Q	8/4/2017	3.1	
3.2	Amended and Restated Bylaws of the registrant	8-K	4/20/2018	3.2	
4.1	Form of registrant's common stock certificate	S-1/A	7/14/2003	4.1	
10.1	2016 Equity Incentive Plan, as amended	8-K	6/2/2020	10.1	
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer				X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer				X
32.1#	Section 1350 Certification of Principal Executive Officer				X
32.2#	Section 1350 Certification of Principal Financial Officer				X
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.				X
101.SCH	Inline XBRL Taxonomy Extension Schema Document				X
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document				X
104*	Cover Page Interactive Data File				X
#	This certification is deemed to accompany this Form 10-Q and will not be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or otherwise subject to the liabilities of that section. This certification will not be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.				
*	Included in Interactive Data File covered by Exhibit 101.				

SIGNATURES

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

NETGEAR, INC.

Registrant

/s/ BRYAN D. MURRAY

Bryan D. Murray
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: July 31, 2020

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Patrick C.S. Lo, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of NETGEAR, Inc. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: July 31, 2020

/s/ PATRICK C.S. LO

Patrick C.S. Lo
Chairman and Chief Executive Officer
NETGEAR, Inc.

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Bryan D. Murray, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of NETGEAR, Inc. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: July 31, 2020

/s/ BRYAN D. MURRAY

Bryan D. Murray

Chief Financial Officer

NETGEAR, Inc.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of NETGEAR, Inc. (the "Company") on Form 10-Q for the period ended June 28, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Patrick C.S. Lo, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 31, 2020

By: /s/ PATRICK C.S. LO
Patrick C.S. Lo
Chairman and Chief Executive Officer
NETGEAR, Inc.

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Form 10-Q), irrespective of any general incorporation language contained in such filing.

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of NETGEAR, Inc. (the "Company") on Form 10-Q for the period ended June 28, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bryan D. Murray, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 31, 2020

By: /s/ BRYAN D. MURRAY

Bryan D. Murray
Chief Financial Officer
NETGEAR, Inc.

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Form 10-Q), irrespective of any general incorporation language contained in such filing.