

**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 27, 2021

☐ **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	Trading symbol(s):	Name of each exchange on which registered
Common Stock, \$0.001 par value	NTGR	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 30,543,590 as of July 23, 2021.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands)

	As of	
	June 27, 2021	December 31, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 328,941	\$ 346,460
Short-term investments	6,378	6,858
Accounts receivable, net of allowance for doubtful accounts of \$1,081 as of June 27, 2021 and December 31, 2020	290,598	337,052
Inventories	251,764	172,112
Prepaid expenses and other current assets	34,110	30,696
Total current assets	911,791	893,178
Property and equipment, net	14,217	16,080
Operating lease right-of-use assets, net	25,798	29,411
Intangibles, net	2,184	3,899
Goodwill	80,721	80,721
Other non-current assets	77,496	82,750
Total assets	\$ 1,112,207	\$ 1,106,039
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 70,381	\$ 90,902
Accrued employee compensation	32,729	35,020
Other accrued liabilities	222,903	218,375
Deferred revenue	15,620	13,458
Income taxes payable	1,719	7,318
Total current liabilities	343,352	365,073
Non-current income taxes payable	20,370	19,174
Non-current operating lease liabilities	21,887	25,512
Other non-current liabilities	3,598	6,896
Total liabilities	389,207	416,655
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	31	30
Additional paid-in capital	906,327	882,709
Accumulated other comprehensive income (loss)	82	(35)
Accumulated deficit	(183,440)	(193,320)
Total stockholders' equity	723,000	689,384
Total liabilities and stockholders' equity	\$ 1,112,207	\$ 1,106,039

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 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Net revenue	\$ 308,811	\$ 280,052	\$ 626,736	\$ 510,015
Cost of revenue	215,455	198,751	422,439	362,473
Gross profit	93,356	81,301	204,297	147,542
Operating expenses:				
Research and development	22,586	21,144	46,415	40,883
Sales and marketing	35,740	34,384	73,555	67,415
General and administrative	15,623	15,481	31,028	28,615
Other operating expenses (income), net	(2,097)	1,425	468	1,093
Total operating expenses	71,852	72,434	151,466	138,006
Income from operations	21,504	8,867	52,831	9,536
Interest income	3	49	13	311
Other income (expense), net	696	314	134	(4,272)
Income before income taxes	22,203	9,230	52,978	5,575
Provision for income taxes	4,369	3,247	12,184	3,765
Net income	\$ 17,834	\$ 5,983	\$ 40,794	\$ 1,810
Net income per share				
Basic	\$ 0.58	\$ 0.20	\$ 1.33	\$ 0.06
Diluted	\$ 0.57	\$ 0.20	\$ 1.29	\$ 0.06
Weighted average shares used to compute net income per share:				
Basic	30,574	29,617	30,614	29,608
Diluted	31,464	30,070	31,648	30,079

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 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Net income	\$ 17,834	\$ 5,983	\$ 40,794	\$ 1,810
Other comprehensive income (loss), before tax:				
Change in unrealized gains and losses on derivatives	87	(418)	134	(15)
Other comprehensive income (loss), before tax	87	(418)	134	(15)
Tax benefit (provision) related to derivatives	(11)	54	(17)	1
Other comprehensive income (loss), net of tax	76	(364)	117	(14)
Comprehensive income	<u>\$ 17,910</u>	<u>\$ 5,619</u>	<u>\$ 40,911</u>	<u>\$ 1,796</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)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholder's Equity
	Shares	Amount				
Balance as of December 31, 2020	30,399	\$ 30	\$ 882,709	\$ (35)	\$ (193,320)	\$ 689,384
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	41	—	41
Net Income	—	—	—	—	22,960	22,960
Stock-based compensation	—	—	6,960	—	—	6,960
Restricted stock unit withholdings	(48)	—	—	—	(1,964)	(1,964)
Issuance of common stock under stock-based compensation plans	407	1	7,041	—	—	7,042
Balance as of March 28, 2021	30,758	31	896,710	6	(172,324)	724,423
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	76	—	76
Net income	—	—	—	—	17,834	17,834
Stock-based compensation	—	—	6,902	—	—	6,902
Repurchase of common stock	(654)	—	—	—	(24,999)	(24,999)
Restricted stock unit withholdings	(106)	—	—	—	(3,951)	(3,951)
Issuance of common stock under stock-based compensation plans	497	—	2,715	—	—	2,715
Balance as of June 27, 2021	30,495	\$ 31	\$ 906,327	\$ 82	\$ (183,440)	\$ 723,000

	Common Stock		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

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 27, 2021	June 28, 2020
Cash flows from operating activities:		
Net income	\$ 40,794	\$ 1,810
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,881	9,383
Stock-based compensation	13,862	15,508
Gain/loss on investments, net	8	4,530
Change in fair value of contingent consideration	(3,003)	89
Deferred income taxes	7,083	2,867
Provision for excess and obsolete inventory	2,255	4,579
Changes in assets and liabilities:		
Accounts receivable	46,455	(323)
Inventories	(81,907)	80,325
Prepaid expenses and other assets	(4,367)	1,031
Accounts payable	(20,477)	(4,791)
Accrued employee compensation	(2,291)	2,769
Other accrued liabilities	4,760	(27,052)
Deferred revenue	1,859	2,281
Income taxes payable	(4,402)	(836)
Net cash provided by operating activities	8,510	92,170
Cash flows from investing activities:		
Purchases of property and equipment	(4,556)	(3,631)
Purchases of long-term investments	(340)	(6,265)
Other	13	2
Net cash used in investing activities	(4,883)	(9,894)
Cash flows from financing activities:		
Repurchases of common stock	(24,999)	(22,508)
Restricted stock unit withholdings	(5,915)	(3,607)
Proceeds from exercise of stock options	6,863	3,786
Proceeds from issuance of common stock under employee stock purchase plan	2,905	2,478
Net cash used in financing activities	(21,146)	(19,851)
Net increase (decrease) in cash and cash equivalents	(17,519)	62,425
Cash and cash equivalents, at beginning of period	346,460	190,208
Cash and cash equivalents, at end of period	\$ 328,941	\$ 252,633

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 6E, WiFi 6, 5G and audio and video over Ethernet. NETGEAR's product line consists 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 its 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, 2020 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, 2020 (the "Annual Report").

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 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

The COVID-19 outbreak, declared as a pandemic by the World Health Organization in March 2020, has had widespread, rapidly-evolving and unpredictable impacts on the global economy, supply chain and work force participation, and created significant volatility and disruption in financial markets. The pandemic has impacted and may continue to impact the Company's supply chain in its ability to timely procure finished goods due to material shortages and freight capacity, its workforce and the operations of its customers, and has led to increased freight rates and material costs. Continued and extended periods of global supply chain, workforce availability and economic disruption could significantly affect the Company's business and statement of financial condition. The duration of the disruption from the pandemic remains uncertain due to the dynamic nature of the virus and its variants, and makes it difficult to reasonably estimate the impact of COVID-19 on the Company's business operations.

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

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

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 27, 2021 are not necessarily indicative of the results that may be expected for the year ending December 31, 2021 or any future period.

Note 2. Summary of Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company's Annual Report. The Company's significant accounting policies have not materially changed during the six months ended June 27, 2021.

Accounting Pronouncements Recently Adopted***ASU 2019-12***

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. The Company adopted the new standard effective January 1, 2021. The adoption had no impact on the Company's financial position, results of operations or cash flows.

ASU 2020-04

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. Effective in the second fiscal quarter of 2021, the Company electively adopted the optional expedients under the new standard and transitioned from LIBOR to Secured Overnight Financing Rate (SOFR) to determine the Company's currency forward rates under its hedging program and its incremental borrowing rate in determining the present value of lease payments. The adoption had no material impact on the Company's 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.

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.

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 were unsatisfied (or partially unsatisfied) as of June 27, 2021:

	<u>1 year</u>	<u>2 years</u>	<u>Greater than 2 years</u>	<u>Total</u>
	(In thousands)			
Performance obligations	\$ 126,016	\$ 1,907	\$ 1,126	\$ 129,049

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 27, 2021 and December 31, 2020, respectively:

	<u>Balance Sheet Location</u>	<u>June 27, 2021</u>	<u>December 31, 2020</u>
		(In thousands)	
Accounts receivable, net	Accounts receivable, net	\$ 290,598	\$ 337,052
Contract liabilities - current	Deferred revenue	\$ 15,620	\$ 13,458
Contract liabilities - non-current	Other non-current liabilities	\$ 2,862	\$ 3,165

The difference in the balances of the Company's contract assets and liabilities as of June 27, 2021 and December 31, 2020 primarily results from the timing difference between the Company's performance and the customer's payment.

During the six months ended June 27, 2021, \$14.8 million of revenue was deferred due to unsatisfied performance obligations for service contracts and undelivered product commitments, \$12.9 million of revenue was recognized for the satisfaction of performance obligations and \$8.9 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 tables, 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 reconciliations 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 27, 2021			June 28, 2020		
	Connected Home	SMB	Total	Connected Home	SMB	Total
Geographic regions:						
Americas	\$ 177,703	\$ 34,931	\$ 212,634	\$ 179,810	\$ 22,436	\$ 202,246
EMEA	32,549	29,223	61,772	31,203	17,156	48,359
APAC	19,611	14,794	34,405	19,004	10,443	29,447
Total	<u>\$ 229,863</u>	<u>\$ 78,948</u>	<u>\$ 308,811</u>	<u>\$ 230,017</u>	<u>\$ 50,035</u>	<u>\$ 280,052</u>
Sales channels:						
Service provider	\$ 35,391	\$ 522	\$ 35,913	\$ 44,152	\$ 871	\$ 45,023
Non-service provider	194,472	78,426	272,898	185,865	49,164	235,029
Total	<u>\$ 229,863</u>	<u>\$ 78,948</u>	<u>\$ 308,811</u>	<u>\$ 230,017</u>	<u>\$ 50,035</u>	<u>\$ 280,052</u>

	Six Months Ended					
	June 27, 2021			June 28, 2020		
	Connected Home	SMB	Total	Connected Home	SMB	Total
Geographic regions:						
Americas	\$ 364,120	\$ 67,664	\$ 431,784	\$ 308,974	\$ 51,462	\$ 360,436
EMEA	63,722	59,140	122,862	49,174	41,333	90,507
APAC	42,939	29,151	72,090	36,532	22,540	59,072
Total	<u>\$ 470,781</u>	<u>\$ 155,955</u>	<u>\$ 626,736</u>	<u>\$ 394,680</u>	<u>\$ 115,335</u>	<u>\$ 510,015</u>
Sales channels:						
Service provider	\$ 57,629	\$ 1,321	\$ 58,950	\$ 70,839	\$ 1,668	\$ 72,507
Non-service provider	413,152	154,634	567,786	323,841	113,667	437,508
Total	<u>\$ 470,781</u>	<u>\$ 155,955</u>	<u>\$ 626,736</u>	<u>\$ 394,680</u>	<u>\$ 115,335</u>	<u>\$ 510,015</u>

Note 4. Balance Sheet Components
Inventories

	As of	
	June 27, 2021	December 31, 2020
	(In thousands)	
Raw materials	\$ 10,809	\$ 7,756
Finished goods	240,955	164,356
Total	<u>\$ 251,764</u>	<u>\$ 172,112</u>

The Company records provisions for excess and obsolete inventory based on assumptions about future demand and market conditions and the amounts incurred were \$1.1 million and \$2.3 million for the three and six months ended June 27, 2021, respectively, and \$2.2 million and \$4.6 million for the three and six months ended June 28, 2020, 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.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Property and equipment, net

	As of	
	June 27, 2021	December 31, 2020
	(In thousands)	
Computer equipment	\$ 9,618	\$ 10,550
Furniture, fixtures and leasehold improvements	18,168	18,674
Software	29,695	29,499
Machinery and equipment	72,072	72,156
Total property and equipment, gross	129,553	130,879
Accumulated depreciation	(115,336)	(114,799)
Total	<u>\$ 14,217</u>	<u>\$ 16,080</u>

Depreciation expense pertaining to property and equipment was \$2.9 million and \$6.0 million for the three and six months ended June 27, 2021, respectively, and \$3.2 million and \$6.2 million for the three and six months ended June 28, 2020, respectively.

Intangibles, net

	As of June 27, 2021			As of December 31, 2020		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(In thousands)					
Technology	\$ 59,799	\$ (58,049)	\$ 1,750	\$ 59,799	\$ (57,835)	\$ 1,964
Customer contracts and relationships	56,800	(56,800)	—	56,800	(55,534)	1,266
Other	10,345	(9,911)	434	10,345	(9,676)	669
Total	<u>\$ 126,944</u>	<u>\$ (124,760)</u>	<u>\$ 2,184</u>	<u>\$ 126,944</u>	<u>\$ (123,045)</u>	<u>\$ 3,899</u>

Amortization of purchased intangibles was \$0.2 million and \$1.7 million for the three and six months ended June 27, 2021, respectively, and \$1.6 million and \$3.2 million for the three and six months ended June 28, 2020, respectively.

Other non-current assets

	As of	
	June 27, 2021	December 31, 2020
	(In thousands)	
Non-current deferred income taxes	\$ 61,223	\$ 68,323
Long-term investments	10,053	8,395
Other	6,220	6,032
Total	<u>\$ 77,496</u>	<u>\$ 82,750</u>

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Long-term investments

The Company's long-term investments are comprised of equity investments without readily determinable fair values, investments in convertible debt and investments in limited partnership funds. The changes in the carrying value of equity investments without readily determinable fair values during the periods represented were as follows:

	Six Months Ended	
	June 27, 2021	June 28, 2020
	(In thousands)	
Carrying value as of the beginning of the period ⁽¹⁾	\$ 7,758	\$ 8,147
Additions from purchase of investments	340	5,815
Impairment	—	(4,530)
Carrying value as of the end of the period ⁽¹⁾	<u>\$ 8,098</u>	<u>\$ 9,432</u>

⁽¹⁾ The balances excluded an investment in limited partnership funds of \$0.6 million, \$0.4 million and \$0.6 million as of June 27, 2021, June 28, 2020 and December 31, 2020, respectively. Additionally, the balance as of June 27, 2021 excluded an investment in convertible debt of \$1.3 million.

For the equity investments without readily determinable fair values as of June 27, 2021, cumulative downward adjustments for price changes and impairment was \$7.9 million and cumulative upward adjustments for price changes was \$0.2 million.

Other accrued liabilities

	As of	
	June 27, 2021	December 31, 2020
	(In thousands)	
Current operating lease liabilities	\$ 8,894	\$ 9,149
Sales and marketing	99,597	83,561
Warranty obligations	7,180	9,240
Sales returns ⁽¹⁾	57,897	66,972
Freight and duty	13,567	14,885
Other	35,768	34,568
Total	<u>\$ 222,903</u>	<u>\$ 218,375</u>

⁽¹⁾ Inventory expected to be received from future sales returns amounted to \$28.0 million and \$32.6 million as of June 27, 2021 and December 31, 2020, respectively. Provisions to write down expected returned inventory to net realizable value amounted to \$16.5 million and \$18.0 million as of June 27, 2021 and December 31, 2020, 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.

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

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.

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 an average USD notional amount of approximately \$6.0 million 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. 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 27, 2021 and June 28, 2020.

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 an average 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 27, 2021, and December 31, 2020, were summarized as follows:

Balance Sheet		June 27, 2021	December 31, 2020	Balance Sheet		June 27, 2021	December 31, 2020
Location				Location			
		(In thousands)				(In thousands)	
Derivatives not designated as hedging instruments	Prepaid expenses and other current assets	\$ 683	\$ 324	Other accrued liabilities	\$ 250	\$ 2,344	
Derivatives designated as hedging instruments	Prepaid expenses and other current assets	98	—	Other accrued liabilities	5	38	
Total		\$ 781	\$ 324		\$ 255	\$ 2,382	

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.

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

The effects of the Company's derivative instruments on AOCI and the unaudited condensed consolidated statements of operations for the three and six months ended June 27, 2021 and June 28, 2020 were summarized as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Derivatives designated as hedging instruments:				
<i>Cash flow hedges</i>				
Foreign currency forward contracts:				
Gains (losses) recognized in accumulated other comprehensive income - Effective Portion	\$ (308)	\$ (63)	\$ (679)	\$ 922
Gains (losses) reclassified from accumulated other comprehensive income into income - Effective Portion ⁽¹⁾ :				
Net revenue	\$ (489)	\$ 343	\$ (952)	\$ 1,019
Cost of revenue	\$ 1	\$ 1	\$ 1	\$ (1)
Research and development	\$ 32	\$ 7	\$ 44	\$ 5
Sales and marketing	\$ 51	\$ 5	\$ 77	\$ (72)
General and administrative	\$ 10	\$ (1)	\$ 17	\$ (14)
Derivatives not designated as hedging instruments:				
Gains (losses) recognized in Other income (expense), net	\$ (363)	\$ (1,128)	\$ 1,053	\$ 650

⁽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 Units ("RSUs") and performance shares, 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 27, 2021 and June 28, 2020 were as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
(In thousands, except per share data)				
Numerator:				
Net income	\$ 17,834	\$ 5,983	\$ 40,794	\$ 1,810
Denominator:				
Weighted average common shares - basic	30,574	29,617	30,614	29,608
Potentially dilutive common share equivalent	890	453	1,034	471
Weighted average common shares - dilutive	31,464	30,070	31,648	30,079
Basic net income per share	\$ 0.58	\$ 0.20	\$ 1.33	\$ 0.06
Diluted net income per share	\$ 0.57	\$ 0.20	\$ 1.29	\$ 0.06
Anti-dilutive employee stock-based awards, excluded	348	2,245	347	2,425

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 27, 2021 was \$4.4 million, or an effective tax rate of 19.7% and \$12.2 million, or an effective tax rate of 23.0%, respectively. 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 increases in tax expense for the three and six months ended June 27, 2021, compared to the prior year periods, were due primarily to higher pre-tax earnings. The increase in tax expense for the three months ended June 27, 2021, compared to the prior year period, was partially offset by tax benefits related to stock-based compensation and non-taxable income related to adjustments to acquisition-related contingent accruals. For the three and six months ended June 28, 2020, tax expenses were increased by valuation allowances recorded on investment impairments during the period as well as the impact of limitations of current and future stock based compensation deductions for certain executive officers under IRC section 162(m).

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 \$0.5 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities. The Company is currently under examination by the U.S. Internal Revenue Service for its fiscal year ended December 31, 2018 as well as other state, local and foreign jurisdictions for different years.

On March 11, 2021, the American Rescue Plan Act of 2021, also known as the COVID-19 Stimulus Package, was signed into law. The provisions of the American Rescue Plan do not have a material impact on income taxes or liquidity in the current year.

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. Commencing at the onset of the COVID-19 pandemic in March 2020, the Company experienced an elongation of the time from order placement to production primarily due to component shortages and supply chain disruptions. The Company has responded by extending its ordering horizon to as long as 18 months. The Company may become liable for non-cancelable material components, such as chipsets purchased by the supplier to meet our purchase order, even if it is subsequently cancelled. 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 27, 2021, the Company had approximately \$133.2 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. 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.

NETGEAR, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Non-Trade Commitments**

As of June 27, 2021, the Company had long term, non-cancellable purchase commitments of \$15.8 million pertaining to non-trade activities.

Warranty Obligations

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Balance as of beginning of the period	\$ 8,176	\$ 9,923	\$ 9,240	\$ 10,556
Provision for warranty liability made	798	1,528	1,761	3,211
Settlements made	(1,794)	(2,176)	(3,821)	(4,492)
Balance as of the end of the period	<u>\$ 7,180</u>	<u>\$ 9,275</u>	<u>\$ 7,180</u>	<u>\$ 9,275</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 27, 2021.

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 27, 2021.

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 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.

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

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.

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.

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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.

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.

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

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. On November 25, 2020, the Federal Circuit affirmed the denial of Cisco's IPR regarding the '231 Patent.

Only the '231 Patent remains from the pending case filed in 2017 described above ("XR I"). The parties are currently scheduled to start claim construction briefing in August 2021 with a hearing set for September 2021, but the case schedule is likely to change as the Judge has consolidated XR I with the newly-filed XR II case below.

On June 16, 2021, XR Communications filed a new suit ("XR II") against the Company in the Central District of California (CDCA) alleging that the Company's 802.11ax compliant products infringe XR's U.S. Patents 7,729,728 (the '728 Patent), 10,594,376 (the '376 Patent), and 8,289,939 (the '939 Patent). The Company is currently assessing XR II.

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 and asserted 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 initially appealed all of the adverse decisions to the Federal Circuit and has since withdrawn 7 of the appeals and filed reissue applications. While the Company awaits the decision on the remaining IPR filed in parallel by Intel, 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 March 11, 2021, the federal court in Northern District of California issued the approval order for the settlement, thereby concluding the federal matter. Three individuals who filed suit in state court requested exclusion from the settlement.

On June 4, 2021, the three individuals—Pham, Perros, and Patel—renewed their state class action case in the Superior Court of California, County of Santa Clara with an amended Complaint. In response, the Company, Arlo and other co-defendants have jointly filed a motion to dismiss and a demurrer to the state court action on June 21, 2021 and July 7, 2021, respectively.

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

NETGEAR, INC.**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 the Company 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.

On September 9, 2020, the Court granted the Defendants' partial motion to dismiss one of the three patents filed in the case, U.S. Pat. 6,839,553 (the '553 Patent). The dismissal was granted without prejudice. The Company filed its Answer on September 23, 2020. On October 20, 2020, Aegis filed an Amended Complaint with additional facts related to the '553 Patent, and added a fourth patent, Pat. 9,350,434 (the '434 patent). In response, the Company renewed its partial motion to dismiss the Amended Complaint.

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

Altair Logix LLC v NETGEAR Inc.

On July 28, 2020, Altair Logix LLC ("Altair") sued the Company in the District of Delaware. Altair's Complaint asserts that the Company's Meural frame infringes U.S. Pat. 6,289,434 (the "434" Patent) titled "Apparatus and Method of Implementing Systems on Silicon Using Dynamic-Adaptive Run-Time Reconfigurable Circuits for Processing Multiple, Independent Data and Control Streams of Varying Rates." The Company filed its Answer on January 12, 2021. The parties are currently conducting discovery. The claim construction process will start in August 2021 with the hearing set for early 2022.

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

Q3 Networking LLC v. NETGEAR Inc.

On September 21 and September 22, 2020, Q3 Networking LLC ("Q3") filed Complaints against the Company, Commscope (with Ruckus and Arris) and Hewlett Packard Enterprises (with Aruba Networks) (together "Defendants" or "Respondents") at the District Court of Delaware and the International Trade Commission ("ITC"), respectively. Both actions allege that the Company's routers and access points infringe four patents: U.S. Pats. 7,457,627 (the '627 Patent), 7,609,677 (the '677 Patent), 7,895,305 (the '305 Patent), and 8,797,853 (the '853 Patent) relating to different aspects of networking technology (e.g., 802.11 and QoS). The ITC case was instituted on October 23, 2020. On November 10, 2020, NETGEAR filed, and the Court granted, a Motion to Stay the Delaware action while the ITC case is pending.

On April 5 and April 6, 2021, the Company and co-respondents filed IPRs against the '627 Patent and '853 Patent, respectively.

Q3 also has a pending case against the Company in China asserting Chinese Patent ZL01809893.2, the Chinese patent corresponding to the '853 Patent, before the Jinan People's Intermediate Court. The Jinan Court has stayed the infringement case pending the result of the invalidity challenge filed by the Company before the China National Intellectual Property Administration (CNIPA). The oral hearing at the CNIPA is scheduled for August 23, 2021.

The ITC case is now in the pre-trial phase of the case and trial is scheduled for July 28 through August 2, 2021.

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

Beijing Tianxing Ebel Information Consulting Co., Ltd v. NETGEAR Inc.

On or around October 19, 2020, Beijing Tianxing Ebel Information Consulting Co., Ltd ("Tianxing") filed two Complaints against the Company in the Beijing Intellectual Property Court ("Beijing IP Court"). Tianxing's Complaints assert that the Company's ReadyNAS RR2304 infringes each of Chinese Patent Nos. ZL200410096563.1 and ZL201010144680.6. The patents are titled "Method for Treating Medium Access Control Address in Main and Spare

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Conversion” and “Network Access Method, System, Network Authentication Method, Equipment and Terminal,” respectively.

In December 2020, NETGEAR Beijing was served with the third suit by Beijing Tianxing. This Complaint asserts that the Company's ReadyNAS RR2304 infringes Chinese Patent No. ZL200510103486.2, titled “System and Method for Processing Link Fault of Wideband Access Apparatus.”

The Company filed jurisdictional objections in all cases, but the Court has denied them. The infringement cases are now back in the substantive trial stage and the Company is preparing its defense.

As of June 11, 2021, the Company has also completed all submissions for the invalidity challenges against the three patents at the CNIPA, and is now awaiting a date for the oral hearing.

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

Network-1 Technologies v. NETGEAR Inc

On December 15, 2020, Network-1 filed a breach of contract suit against the Company in New York State Court for failure to pay royalties for its Power over Ethernet (“PoE”) products under the parties’ Settlement and Licensing Agreement (“Agreement”). The Company disagrees with Network-1’s position on the Agreement. The parties did not reach an agreement in mediation. The Company has filed a motion to compel arbitration pursuant to the Agreement and the parties are awaiting the Court’s decision.

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

2BCom v. NETGEAR Inc.

On January 13, 2021, 2BCom sued the Company in the Northern District of California. 2BCom’s Complaint asserts that the Company's routers infringe U.S. Pats. 6,885,643 (the “434 Patent”), 6,928,166 (the “166 Patent”), 7,039,445 (the “445 Patent”), 7,460,477 (the “477 Patent”) based on 802.11 and other standards. On April 15, 2021, the Company filed its Answer to the case.

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

WSOU v. NETGEAR Inc.

On January 13, 2021, WSOU Investments, LLC (WSOU) filed three complaints against the Company in the US District Court for the Western District of Texas (WDTX). WSOU alleges that the Company’s routers and switches infringe three patents related to wireless communication technologies. The patents asserted are US Patent Nos.: 7,512,096 (the “096 Patent”), 9,338,171 (the “171 Patent”) and 7,551,630 (the “630 Patent”). On April 15, 2021, the Company filed motions to dismiss for improper venue or to transfer in lieu of answering in all three cases. The parties are currently conducting jurisdictional discovery.

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

Shenzhen Yuanyu and Gaoping Yaoyi v. NETGEAR Beijing

On or around March 19, 2021, the Company’s Beijing entity was served in seven patent infringement suits filed by Shenzhen Yuanyu Investment Co., Ltd. and Gaoping Yaoyi Trading Co., Ltd., at the Jinan Intermediate People’s Court. Shenzhen Yuanyu asserted Chinese patents ZL201010616817.3, ZL200610168028.1, ZL200410057124.X, ZL200710074176.1 in four separate suits. Gaoping Yaoyi asserted Chinese patents ZL200410080537.X, ZL200810126154.X, and 200710086745.4 in three separate suits. All cases allege the Company’s Nighthawk XR300 and XR500 infringe the patent.

As of June 28, 2021, the Company has completed all submissions for the invalidity challenges against the seven patents at the CNIPA. The Jinan Court has stayed the infringement case pending the results of the invalidity challenges.

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

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

Beijing Yiwen v. NETGEAR Beijing

On or around April 1, 2021, the Company's Beijing entity was served in two patent infringement cases filed by Beijing Yiwen Impression Advertisement Co., Ltd., Beijing Yiwen sued NETGEAR Beijing at the Beijing IP Court alleging the Company's GS748T infringes Chinese patents ZL200510103486.2 and ZL200510120823.9. The Company filed jurisdictional challenges in both of the infringement cases and is awaiting the Court's ruling.

As of June 11, 2021, the Company completed all submissions for the invalidity challenges against both patents at the CNIPA, and is now awaiting a date for the oral hearing.

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

Shangdong Chengzi Medical Technology v. NETGEAR Beijing

On or around June 8, 2021, the Company's Beijing entity was served in two China patent infringement cases. Plaintiff Shangdong Chengzi sued NETGEAR Beijing at the Beijing IP Court alleging the Company's Orbi RBR20 and XR500 infringe Chinese patent ZL200810007497.4, titled "A method and device for pre-alarmed exception." The Company filed jurisdictional challenges in both cases and is awaiting the Court's ruling.

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

Gaoping Yaoyi Trading Co. v. NETGEAR Beijing

On or around June 9, 2021, the Company was served in two China patent infringement cases. Plaintiff Gaoping Yaoyi, sued NETGEAR Beijing at the Liuzhou Intermediate People's Court alleging the Company's XR300 infringes Chinese patent ZL200710162875.1 and ZL201110389019.6, titled "Data stream information transmission method, communication system and equipment" and "Network access management method and network access device," respectively. The Company filed jurisdictional challenges in both infringement cases and is awaiting the Court's ruling.

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

TrackThings LLC v. NETGEAR

On June 21, 2021, TrackThings, a non-practicing entity, sued the Company in the Southern District of New York (SDNY). TrackThings asserts that the Company's Orbi and Nighthawk mesh products infringe three patents related to mesh technology: U.S. Patent No. 9,642,017 (the '017 Patent), titled "Apparatus and Method for Improving the Integrity and Performance of an Ad-Hoc Wireless Network," U.S. Patent No. 9,332,442 (the '442 Patent) titled "Apparatus and Method of a Configurable Network," and U.S. Patent No. 10,107,893 (the '893 Patent) titled "Apparatus and Method to Automatically Set a Master-Slave Monitoring System." The Company's Answer is due August 30, 2021.

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

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 27, 2021, 2.0 million shares remained authorized for repurchase under the repurchase program. During the six months ended June 27, 2021 and June 28, 2020, the Company

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

repurchased, reported based on trade date, approximately 0.7 million and 0.9 million shares of common stock, respectively, at a cost of approximately \$ 25.0 million and \$22.5 million, respectively, under the repurchase authorizations.

The Company repurchased, reported based on trade date, approximately 154,000 and 149,000 shares of common stock, at a cost of approximately \$5.9 million and \$3.6 million, during the six months ended June 27, 2021 and June 28, 2020, respectively, to administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs.

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 tables set forth the changes in accumulated other comprehensive income ("AOCI") by component during the six months ended June 27, 2021 and June 28, 2020:

	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, 2020	\$ (2)	\$ (42)	\$ 9	\$ (35)
Other comprehensive income (loss) before reclassifications	—	(679)	154	(525)
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	(813)	171	(642)
Net current period other comprehensive income (loss)	—	134	(17)	117
Balance as of June 27, 2021	<u>\$ (2)</u>	<u>\$ 92</u>	<u>\$ (8)</u>	<u>\$ 82</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, 2019	\$ (2)	\$ 22	\$ 1	\$ 21
Other comprehensive income (loss) before reclassifications	—	922	(196)	726
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	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>

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

The following table provides details about significant amounts reclassified out of each component of AOCI for the three and six months ended June 27, 2021 and June 28, 2020:

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
(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	\$ (489)	\$ 343	\$ (952)	\$ 1,019
Cost of revenue	1	1	1	(1)
Research and development	32	7	44	5
Sales and marketing	51	5	77	(72)
General and administrative	10	(1)	17	(14)
Total before tax	(395)	355	(813)	937
Tax impact	83	(75)	171	(197)
Total, net of tax	<u>\$ (312)</u>	<u>\$ 280</u>	<u>\$ (642)</u>	<u>\$ 740</u>

Note 10. Employee Benefit Plans

The Company grants options, RSUs and performance shares under the 2016 Incentive Plan (the "2016 Plan"), under which awards may be granted to all employees. Vesting periods under this plan are generally four years for options and RSUs and three years for performance shares. As of June 27, 2021, approximately 2.2 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 semi-annually 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 27, 2021, approximately 0.3 million shares were available for issuance under the ESPP.

Option Activity

Stock option activity during the six months ended June 27, 2021 was as follows:

	Number of Shares	Weighted Average Exercise Price Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2020	1,333	\$ 27.86
Exercised	(292)	\$ 23.43
Outstanding as of June 27, 2021	<u>1,041</u>	<u>\$ 29.10</u>

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

RSU activity during the six months ended June 27, 2021 was as follows:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2020	1,584	\$ 30.66
Granted	479	\$ 39.42
Vested	(507)	\$ 31.94
Cancelled	(90)	\$ 32.67
Outstanding as of June 27, 2021	1,466	\$ 32.96

Performance Shares Activity

In July 2020, the Company's executive officers were granted performance shares with vesting occurring at the end of a three-year period if performance conditions are met. The number of performance shares earned and eligible to vest are determined based on achievement of the pre-determined performance conditions and the recipients' continued service with the Company. The number of performance shares to vest could range from 0% to 150% of the target shares granted. At the end of each reporting period, the Company evaluates the probability of achieving the performance conditions and records the related stock-based compensation expense based on performance to date over the service period.

Performance shares activity during the six months ended June 27, 2021 was as follows:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2020	141	\$ 28.22
Granted	—	\$ —
Vested	—	\$ —
Cancelled	—	\$ —
Outstanding as of June 27, 2021	141	\$ 28.22

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 and performance shares 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.

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

No options were granted during the three or six months ended June 27, 2021 and June 28, 2020 and no purchase rights were granted during the three months ended June 27, 2021 and June 28, 2020. 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 27, 2021 and June 28, 2020:

	Six Months Ended	
	June 27, 2021	June 28, 2020
ESPP		
Expected life (in years)	0.5	0.5
Risk-free interest rate	0.06%	1.55%
Expected volatility	50.0%	38.8%
Dividend yield	—	—

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
(In thousands)				
Cost of revenue	\$ 362	\$ 1,501	\$ 1,196	\$ 2,206
Research and development	1,272	1,707	2,418	2,741
Sales and marketing	1,953	1,890	3,733	3,669
General and administrative	3,315	4,074	6,515	6,892
Total	\$ 6,902	\$ 9,172	\$ 13,862	\$ 15,508

As of June 27, 2021, \$1.6 million of unrecognized compensation cost related to stock options was expected to be recognized over a weighted-average period of 1.0 years and \$40.8 million of unrecognized compensation cost related to unvested RSUs and performance shares was expected to be recognized over a weighted-average period of 2.5 years.

Note 11. Segment Information

Operating segments are components of an enterprise about which separate financial information is available and is evaluated quarterly 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 6 Tri Band mesh systems, routers, 4G/5G mobile products, smart devices such as Meural digital canvasses, and subscription services, offering consumers a range of value added services, including 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, video over Ethernet for Pro AV applications, security and remote management 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 that it 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

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

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, change in fair value of contingent consideration, restructuring and other charges, litigation reserves, net, interest income and other income (expense), net.

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 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Net Revenue:				
Connected Home	\$ 229,863	\$ 230,017	\$ 470,781	\$ 394,680
SMB	78,948	50,035	155,955	115,335
Total net revenue	<u>\$ 308,811</u>	<u>\$ 280,052</u>	<u>\$ 626,736</u>	<u>\$ 510,015</u>
Contribution Income:				
Connected Home	\$ 31,328	\$ 36,187	\$ 78,631	\$ 49,774
Contribution margin	13.6%	15.7%	16.7%	12.6%
SMB	\$ 16,410	\$ 4,285	\$ 32,694	\$ 17,852
Contribution margin	20.8%	8.6%	21.0%	15.5%
Total segment contribution income	\$ 47,738	\$ 40,472	\$ 111,325	\$ 67,626
Corporate and unallocated costs	(21,251)	(19,489)	(42,541)	(38,451)
Amortization of intangibles (1)	(178)	(1,519)	(1,623)	(3,038)
Stock-based compensation expense	(6,902)	(9,172)	(13,862)	(15,508)
Change in fair value of contingent consideration	3,003	(311)	3,003	(89)
Restructuring and other charges	(886)	(1,117)	(3,156)	(982)
Litigation reserves, net	(20)	3	(315)	(22)
Interest income	3	49	13	311
Other income (expense), net (2)	696	314	134	(4,272)
Income before income taxes	<u>\$ 22,203</u>	<u>\$ 9,230</u>	<u>\$ 52,978</u>	<u>\$ 5,575</u>

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

(2) Amounts included gain/loss on investments, net, of \$41,000 and \$(8,000) for the three and six months ended June 27, 2021, respectively, and \$0 and \$(4.5) million for the three and six months ended June 28, 2020, respectively.

The CODM does not evaluate operating segments using discrete asset information.

Operations by Geographic Region

For reporting purposes, revenue is generally attributed to each geographic region based on the location of the customer.

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

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
	(In thousands)			
United States (U.S.)	\$ 205,108	\$ 197,833	\$ 418,726	\$ 352,638
Americas (excluding U.S.)	7,526	4,413	13,058	7,798
EMEA	61,772	48,359	122,862	90,507
APAC	34,405	29,447	72,090	59,072
Total net revenue	<u>\$ 308,811</u>	<u>\$ 280,052</u>	<u>\$ 626,736</u>	<u>\$ 510,015</u>

Long-lived assets by Geographic Region

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

	As of	
	June 27, 2021	December 31, 2020
	(In thousands)	
United States (U.S.)	\$ 16,683	\$ 19,173
Americas (excluding U.S.)	2,207	2,845
EMEA	2,901	3,215
Singapore	5,322	5,964
APAC (excluding Singapore) (1)	12,902	14,294
Total	<u>\$ 40,015</u>	<u>\$ 45,491</u>

(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 27, 2021 and December 31, 2020:

	As of June 27, 2021			
	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	\$ 162,893	\$ 162,893	\$ —	\$ —
Available-for-sale investments: certificates of deposit(1)	152	—	152	—
Trading securities: mutual funds(1)	6,226	6,226	—	—
Foreign currency forward contracts(2)	781	—	781	—
Long-term investments: convertible debt(3)	1,326	—	—	1,326
Total assets measured at fair value	<u>\$ 171,378</u>	<u>\$ 169,119</u>	<u>\$ 933</u>	<u>\$ 1,326</u>
Liabilities:				
Foreign currency forward contracts(4)	\$ 255	\$ —	\$ 255	\$ —
Total liabilities measured at fair value	<u>\$ 255</u>	<u>\$ —</u>	<u>\$ 255</u>	<u>\$ —</u>

NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	As of December 31, 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	\$ 158,054	\$ 158,054	\$ —	\$ —
Available-for-sale debt investments: convertible debt ⁽¹⁾	1,326	—	—	1,326
Available-for-sale investments: certificates of deposit ⁽¹⁾	165	—	165	—
Trading securities: mutual funds ⁽¹⁾	5,368	5,368	—	—
Foreign currency forward contracts ⁽²⁾	324	—	324	—
Total assets measured at fair value	<u>\$ 165,237</u>	<u>\$ 163,422</u>	<u>\$ 489</u>	<u>\$ 1,326</u>
Liabilities:				
Foreign currency forward contracts ⁽⁴⁾	\$ 2,382	\$ —	\$ 2,382	\$ —
Contingent consideration ⁽⁵⁾	3,000	—	—	3,000
Total liabilities measured at fair value	<u>\$ 5,382</u>	<u>\$ —</u>	<u>\$ 2,382</u>	<u>\$ 3,000</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 non-current assets on the Company's unaudited condensed consolidated balance sheets.

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

(5) 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.

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. In the three months ended June 27, 2021, the Company released \$3.0 million of a contingent consideration liability associated with acquisition of Meural given remote probability of milestone achievement. 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.

NETGEAR, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
Note 13. Restructuring and Other Charges

The Company accounts for its restructuring plans under the authoritative guidance for exit or disposal activities. The Company includes expenses related to restructuring and other charges in Other operating expenses (income), net in the unaudited condensed consolidated statements of operations. Accrued restructuring and other charges are classified within Accrued employee compensation and Other accrued liabilities on the unaudited condensed consolidated balance sheets.

Restructuring and other charges recognized in the six months ended June 27, 2021 were primarily for severance, and other costs in relation to the consolidation of offices in the APAC region and the reorganization of our supply chain function to gain some cost efficiencies. The remaining liabilities as of June 27, 2021 are expected to be settled in the third fiscal quarter of 2021.

The following table provides a summary of the activity related to accrued restructuring and other charges for the six months ended June 27, 2021:

	Accrued Restructuring and Other Charges at December 31, 2020	Additions ⁽¹⁾	Cash Payments	Adjustments	Accrued Restructuring and Other Charges at June 27, 2021
	(In thousands)				
Restructuring					
Employee termination charges	\$ 87	\$ 2,670	\$ (1,924)	\$ (23)	\$ 810
Lease contract termination and other charges	227	502	(532)	(134)	63
Total Restructuring and other charges	<u>\$ 314</u>	<u>\$ 3,172</u>	<u>\$ (2,456)</u>	<u>\$ (157)</u>	<u>\$ 873</u>

⁽¹⁾ Total restructuring and other charges recognized in the Company's unaudited condensed consolidated statements of operations for the period presented included non-cash charges and adjustments, net of \$0.1 million, which were excluded from the table above.

Note 14. 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 approximately 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 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
	(In Thousands)			
Operating lease cost	\$ 2,176	\$ 2,471	\$ 4,570	\$ 5,351
Short-term lease cost	83	554	413	668
Total lease cost ⁽¹⁾	<u>\$ 2,259</u>	<u>\$ 3,025</u>	<u>\$ 4,983</u>	<u>\$ 6,019</u>

⁽¹⁾ 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 27, 2021	June 28, 2020
	(In Thousands)	
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows relating to operating leases	\$ 4,684	\$ 6,257
Lease liabilities arising from obtaining right-of-use assets:		
Operating leases	\$ 340	\$ 7,503

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. 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, WiFi 6E, 5G and audio and video over Ethernet. Our product line consists 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 that it 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 6 Tri Band mesh systems, routers, 4G/5G mobile products, smart devices such as Meural digital canvasses, and subscription services, offering consumers a range of value added services, including 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, video over Ethernet for Pro AV applications, security and remote management 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").

Business Overview

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 through our online platform at www.netgear.com. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Costco, Walmart, Staples, Office Depot, Target, FNAC (Europe), MediaMarkt (Europe), JB HiFi (Australia), Elkjop (Norway) and Sunning and Guomei (China). Online retailers include Amazon.com worldwide, Newegg.com (U.S.), JD.com, Alibaba (China) and 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. While we expect these channels to continue to be a significant part of our sales strategy, we believe that the proportion of sales through e-commerce platforms will continue to grow in the foreseeable future.

Financial Overview

During the three months ended June 27, 2021, our net revenue and income from operations increased by \$28.8 million and \$12.6 million, respectively, compared to the prior year period. The increase in net revenue was primarily driven by higher net revenue from SMB products due to strong demand for work from home solutions and benefited from an improved operating environment as the prior year period was adversely affected by business closures due to the COVID-19 pandemic. Net revenue from Connected Home products was in line with prior year performance as increased net revenue from consumer channels was offset by a decline in net revenue from service provider customers. The increase in net revenue generated an increase in gross profit of \$12.1 million while operating expenses decreased by \$0.6 million.

On a geographic basis, net revenue increased across all three regions during the three months ended June 27, 2021, compared to the prior year period. The increases were primarily attributable to higher net revenue from SMB products.

COVID-19 Pandemic Update

The COVID-19 outbreak, declared as a pandemic by the World Health Organization in March 2020, has had widespread, rapidly-evolving and unpredictable impacts on the global economy, supply chains and work force participation and created significant volatility and disruption in financial markets. Our focus remains on promoting employee health and safety, serving our customers and ensuring business continuity. As a result, we have taken actions to direct the majority of our worldwide workforce to work from home, suspend travel and replace in-person events with digital events. We continue to actively monitor the situation, including progress made through vaccinations, which we expect will enable us to reopen offices, and will make further changes to our business operations.

The COVID-19 pandemic has brought about a considerable shift in our business while increasing uncertainty. We have experienced an increase in demand for our products relative to pre-pandemic levels as consumers and businesses seek flexible networking solutions for their day to day needs. We expect the shift to remote working to increase relative to the experience pre-pandemic, thus maintaining the demand for high performance and dependable WiFi networks with a sustained increase in our target addressable market. As a result of the on-going pandemic, our supply chain partners are limited by production capacity, constrained by material availability, factory uptime and freight capacity, which results in elongated lead times to some of our key components, constrains our ability to accurately forecast and our ability to capitalize fully on end market demand. We expect supply chain constraints to continue to exist throughout 2021 for certain products. We anticipate the performance of Connected Home products in the second half of 2021 to be in line with the first half of 2021 as the demand surge that commenced upon the onset of the pandemic in March 2020 started to moderate in the second fiscal quarter of 2021, with demand coming in light to expectations. Additionally, we anticipate increased demand for SMB products fueled by new business formations and demand for flexible working environments and increasing demand for our Pro AV solutions. We will look to continue to execute on our strategy of capitalizing on technological inflection points of WiFi 6E, WiFi 6, 5G and audio and video over Ethernet, to develop and expand the premium WiFi market through new product introductions and develop and roll out service offerings to build recurring service revenue streams. While we have been successful in navigating COVID-19 related supply chain challenges to date, any further disruption brought about by the COVID-19 pandemic to supply chain partners, production schedules, material availability or freight carriers or any increases to costs associated with supply chain operations could have a significant negative impact on our net revenue, 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 of the pandemic and the broader implications of the macro-economic recovery, any related disruptions to channel partners and restrictions on travel and transport, all of which are uncertain and cannot be predicted. A large portion of our global workforce has been working remotely as a result of the pandemic for over a year. Their comfort level and willingness to switch from remote working to a hybrid or full time in person model is uncertain and cannot be predicted. 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.

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. Refer to *Note 1. The Company and Basis of Presentation*, 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.

Results of Operations

The following table sets forth the unaudited condensed consolidated statements of operations for the three and six months ended June 27, 2021, with the comparable reporting periods in the preceding year.

	Three Months Ended				Six Months Ended			
	June 27, 2021		June 28, 2020		June 27, 2021		June 28, 2020	
	(In thousands, except percentage data)							
Net revenue	\$ 308,811	100.0%	\$ 280,052	100.0%	\$ 626,736	100.0%	\$ 510,015	100.0%
Cost of revenue	215,455	69.8%	198,751	71.0%	422,439	67.4%	362,473	71.1%
Gross profit	93,356	30.2%	81,301	29.0%	204,297	32.6%	147,542	28.9%
Operating expenses:								
Research and development	22,586	7.3%	21,144	7.6%	46,415	7.4%	40,883	8.0%
Sales and marketing	35,740	11.5%	34,384	12.2%	73,555	11.7%	67,415	13.2%
General and administrative	15,623	5.1%	15,481	5.5%	31,028	5.0%	28,615	5.6%
Other operating expenses								
(income), net	(2,097)	(0.7)%	1,425	0.5%	468	0.1%	1,093	0.2%
Total operating expenses	71,852	23.2%	72,434	25.8%	151,466	24.2%	138,006	27.0%
Income from operations	21,504	7.0%	8,867	3.2%	52,831	8.4%	9,536	1.9%
Interest income	3	0.0%	49	0.0%	13	0.0%	311	0.0%
Other income (expense), net	696	0.2%	314	0.1%	134	0.1%	(4,272)	(0.8)%
Income before income taxes	22,203	7.2%	9,230	3.3%	52,978	8.5%	5,575	1.1%
Provision for income taxes	4,369	1.4%	3,247	1.2%	12,184	2.0%	3,765	0.7%
Net income	\$ 17,834	5.8%	\$ 5,983	2.1%	\$ 40,794	6.5%	\$ 1,810	0.4%

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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020		
(In thousands, except percentage data)								
Americas	\$ 212,634	5.1%	\$ 202,246	\$ 431,784	19.8%	\$ 360,436		
Percentage of net revenue	68.9%		72.2%	68.9%		70.7%		
EMEA	\$ 61,772	27.7%	\$ 48,359	\$ 122,862	35.7%	\$ 90,507		
Percentage of net revenue	20.0%		17.3%	19.6%		17.7%		
APAC	\$ 34,405	16.8%	\$ 29,447	\$ 72,090	22.0%	\$ 59,072		
Percentage of net revenue	11.1%		10.5%	11.5%		11.6%		
Total net revenue	\$ 308,811	10.3%	\$ 280,052	\$ 626,736	22.9%	\$ 510,015		

Americas

Net revenue in Americas increased for the three months ended June 27, 2021, compared to the prior year period, primarily due to higher demand for SMB products buoyed by business formations and increased demand for flexible work from home solutions. Net revenue in Americas increased for the six months ended June 27, 2021, compared to the prior year period, mainly attributable to increased demand for both Connected Home and SMB products. Commencing March 2020, we experienced a surge in demand for Connected Home products in response to work and schooling from home mandates resulting from the COVID-19 pandemic with demand for premium, highly reliable and high-speed internet connectivity covering the entire home becoming a necessity. The demand increase in Connected Home was driven by home wireless, particularly WiFi 6 mesh systems, WiFi 6 routers, as well as broadband modem and gateway products. SMB net revenue in Americas rose by 55.7% and 31.5% for the three and six months ended June 27, 2021, compared to the prior year periods, respectively, predominantly due to higher net revenue from our switch products. In addition, the SMB performance in the three months ended June 27, 2021, compared to the prior year period, was assisted by the re-opening of economies while the prior year performance was negatively impacted by business closures brought about by the COVID-19 pandemic.

EMEA

Net revenue in EMEA increased for the three and six months ended June 27, 2021, compared to the prior year periods, driven by strong demand for both SMB and Connected Home products. SMB net revenue in EMEA grew by 70.3% and 43.1% for the three and six months ended June 27, 2021, compared to the prior year periods, respectively, mainly attributable to higher net revenue of switch and SMB wireless products driven by strong demand for work from home solutions. The year over year performance of SMB products was further benefitted by the re-opening of economies while the prior year periods' performance was negatively impacted by business closures resulting from the COVID-19 pandemic. Connected Home net revenue in EMEA increased by 4.3% and 29.6% in the three and six months ended June 27, 2021, compared to the prior year periods, respectively, mainly driven by growing demand for premium and high-performance home wireless products, particularly WiFi 6 mesh systems.

APAC

Net revenue in APAC increased for the three and six months ended June 27, 2021, compared to the prior year periods, mainly driven by strong demand for switch and SMB wireless products in SMB segment. SMB net revenue in APAC increased by 41.7% and 29.3% for the three and six months ended June 27, 2021, compared to the prior year periods, respectively. Further, Connected Home net revenue increased by 17.5% for the six months ended June 27, 2021, compared with the prior year period, largely due to increased net revenue from home wireless products. The year over year performance improvement was due to a combination of increased demand and an improved economic environment, while the first half of the prior year was negatively impacted due to the onset of the COVID-19 pandemic.

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, royalty and licensing fees, 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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Cost of revenue	\$ 215,455	8.4%	\$ 198,751	\$ 422,439	16.5%	\$ 362,473
Gross margin percentage	30.2%		29.0%	32.6%		28.9%

Cost of revenue increased for the three and six months ended June 27, 2021 compared to the prior year periods, mainly due to higher net revenue and higher freight expense as a proportion of net revenue.

Gross margin increased for the three and six months ended June 27, 2021, compared to the prior year periods, primarily due to improved product margins, partially offset by higher channel promotional activities deemed to be a reduction of revenue and higher freight expense as a proportion of net revenue. The improved product margins were mainly due to improved product mix with SMB products comprising a higher proportion of net revenue, and higher product margin attainment on Connected home products and higher service revenue.

For the second half of fiscal 2021, we expect gross margins to trend in line with the comparative periods of 2020. We have experienced disruptions to our supply chain since the onset of the pandemic, with partners being affected by factory uptime, scarcity of component materials and limited capacity to transport cargo via sea and air. These disruptions have resulted in the time from order to production and transportation of inventory to our distribution centers increasingly elongating. Additionally, we have experienced increases to material costs and transportation cost. If such disruptions become widespread, they could significantly hamper our ability to fulfill the demand for our products, in particular our SMB products, while continued increases to costs associated with supply chain could impact our margin performance. 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, competition, the timing of sales, and related production level variances; import customs duties and imposed tariffs; changes in technology; changes in product mix; expenses associated with writing off excessive or obsolete inventory; 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; and warranty costs. 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. 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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Research and development	\$ 22,586	6.8%	\$ 21,144	\$ 46,415	13.5%	\$ 40,883

Research and development expense increased for the three and six months ended June 27, 2021, mainly due to increases in personnel-related expenditures of \$2.3 million and \$5.8 million, partially offset by decreases in outside professional services of \$0.6 million and \$0.3 million, compared to the prior year periods, respectively. The increases in personnel-related expenditures were mainly attributable to the growth of our software engineering team, and we incurred higher bonus expense associated with higher profitability, for the three and six months ended June 27, 2021, compared to the prior year periods. Research and development headcount increased to 282 as of June 27, 2021 from 277 as of June 28, 2020.

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. We continue to invest in research and development to grow our cloud platform capabilities, our services and mobile applications and to expand our hardware product offerings focused on WiFi 6E, WiFi 6, Advanced 4G/5G mobile and 5G coverage solutions, audio and video over Ethernet, web-managed, app-managed, 10Gig and PoE switch products. We expect research and development expense as a percentage of net revenue in the remainder of the year to be consistent with the first half of fiscal 2021 experience. 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 described above. 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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Sales and marketing	\$ 35,740	3.9%	\$ 34,384	\$ 73,555	9.1%	\$ 67,415

Sales and marketing expense increased for the three and six months ended June 27, 2021, compared to the prior year periods, primarily due to increases in marketing expenditures of \$1.4 million and \$3.0 million, respectively, to support the higher revenue achievement in the consumer channels. Furthermore, the increase in Sales and marketing expense for the six months ended June 27, 2021, compared to the prior year period, was mainly due to increases in outbound freight costs of \$1.7 million and outside professional services of \$1.5 million primarily attributable to customer support expenses incurred to support the increased revenue achievement. Sales and marketing headcount was 259 as of June 27, 2021, compared to 262 as of June 28, 2020.

We expect our sales and marketing expense as a percentage of net revenue in the remainder of 2021 to be slightly above the levels of the comparative periods 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 revenue 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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
General and administrative	\$ 15,623	0.9%	\$ 15,481	\$ 31,028	8.4%	\$ 28,615

General and administrative expense stayed relatively flat for the three months ended June 27, 2021, compared to the prior year period, with an increase in legal and professional services spending of \$1.3 million being partially offset by a decline in personnel-related expenditures of \$1.1 million. General and administrative expense increased for the six months ended June 27, 2021, compared to the prior year period, primarily due to an increase in legal and professional services of \$2.2 million. The increase in legal service spending was attributable to higher patent litigation activity. General and administrative headcount was 135 as of June 27, 2021 compared to 143 as of June 28, 2020.

We expect our general and administrative expenses as a percentage of net revenue in the remainder of 2021 to be slightly above the comparative periods 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 (income), net

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

	Three Months Ended			Six Months Ended		
	June 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Other operating expenses (income), net	\$ (2,097)	**	\$ 1,425	\$ 468	(57.2)%	\$ 1,093

** Percentage change not meaningful.

The change in other operating expenses (income), net for the three months ended June 27, 2021, compared to the prior year period, was primarily related to a \$3.0 million release of a contingent consideration liability associated with a prior acquisition given remote probability of milestone achievement. The decrease in other operating expenses (income), net for the six months ended June 27, 2021, compared to the prior year period, was primarily due to the \$3.0 million release of contingent consideration discussed earlier, partially offset by higher restructuring and other charges of \$2.2 million associated with the consolidation of offices in the APAC region and the reorganization of our supply chain function in the first half of 2021. For a detailed discussion of restructuring and other charges, refer to *Note 13. Restructuring and Other Charges*, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

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 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Interest income	\$ 3	(93.9)%	\$ 49	\$ 13	(95.8)%	\$ 311
Other income (expense), net	696	121.7%	314	134	**	(4,272)
Total	<u>\$ 699</u>	<u>92.6%</u>	<u>\$ 363</u>	<u>\$ 147</u>	<u>**</u>	<u>\$ (3,961)</u>

** Percentage change not meaningful.

The changes in interest income for the three and six months ended June 27, 2021, compared to the prior year periods, were not significant.

The change in other income (expense), net in the six months ended June 27, 2021, compared to the prior year period, was primarily attributable to \$4.5 million of impairment charges, recognized in the three months ended March 29, 2020 and brought about by triggering events impacting the valuation of a number of our privately held long-term investments.

Provision for Income Taxes

	Three Months Ended			Six Months Ended		
	June 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(In thousands, except percentage data)						
Provision for income taxes	\$ 4,369	34.6%	\$ 3,247	\$ 12,184	223.6%	\$ 3,765
Effective tax rate	19.7%		35.2%	23.0%		67.5%

The increases in tax expense for the three and six months ended June 27, 2021, compared to the prior year periods, were primarily due to higher pre-tax earnings. The increase in tax expense for the three months ended June 27, 2021, compared to the prior year period, was partially offset by tax benefits related to stock-based compensation and non-taxable income related to adjustments to acquisition-related contingent accruals. For the three and six months ended June 28, 2020, tax expenses were increased by valuation allowances recorded on investment impairments during the period as well as the impact of limitations of current and future stock-based compensation deductions for certain executive officers under IRC section 162(m).

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 are currently under examination by the U.S. Internal Revenue Service ("IRS") for our fiscal year ended December 31, 2018. We are also under examination in various other state, local and foreign jurisdictions.

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*, and information on net revenue by sales channels can be found in *Disaggregation of Revenue* in [Note 3. Revenue](#), 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 Segment

	Three Months Ended			Six Months Ended		
	June 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(in thousands, except percentage data)						
Net revenue	\$ 229,863	(0.1)%	\$ 230,017	\$ 470,781	19.3%	\$ 394,680
Percentage of net revenue	74.4%		82.1%	75.1%		77.4%
Contribution income	\$ 31,328	(13.4)%	\$ 36,187	\$ 78,631	58.0%	\$ 49,774
Contribution margin	13.6%		15.7%	16.7%		12.6%

Net revenue for the Connected Home was flat in the three months ended June 27, 2021, compared to the prior year period, as increased net revenue from consumer channels was offset by a decline in sales to service provider customers. We experienced increased net revenue from broadband modem and gateway products, offset by decreases in net revenue from mobile and home wireless products, compared to the prior year period. The increase in Connected Home net revenue in the six months ended June 27, 2021, compared to prior year period, was primarily due to increased demand for high performance, dependable WiFi equipment to support unprecedented bandwidth consumption in the home, where people transitioned to conducting the majority of their daily lives after the onset of the pandemic. Connected Home net revenue in consumer channels increased by \$89.3 million in the six months ended June 27, 2021, compared to the prior year period, mainly due to higher net revenue from home wireless, particularly WiFi 6 mesh systems, and WiFi 6 routers and extenders, and broadband modem and gateway products. Geographically, net revenue increased in EMEA and APAC, but decreased in Americas for the three months ended June 27, 2021, whereas we experienced increases in net revenue across all regions in the six months ended June 27, 2021, compared to prior year period.

Connected Home contribution income decreased in the three months ended June 27, 2021, compared to the prior year period, primarily due to higher operating expenses and slightly lower gross margin achievement. Connected Home contribution income increased in the six months ended June 27, 2021, compared to the prior year period, primarily due to higher net revenue and higher gross margin attainment.

SMB Segment

	Three Months Ended			Six Months Ended		
	June 27, 2021	% Change	June 28, 2020	June 27, 2021	% Change	June 28, 2020
(in thousands, except percentage data)						
Net revenue	\$ 78,948	57.8%	\$ 50,035	\$ 155,955	35.2%	\$ 115,335
Percentage of net revenue	25.6%		17.9%	24.9%		22.6%
Contribution income	\$ 16,410	283.0%	\$ 4,285	\$ 32,694	83.1%	\$ 17,852
Contribution margin	20.8%		8.6%	21.0%		15.5%

SMB net revenue increased significantly for the three and six months ended June 27, 2021, compared to the prior year periods, due to strong demand for work from home solutions, including low port count switches and wireless products while demand for Pro AV applications increased meaningfully year over year. The year over year performance in the three months ended June 27, 2021, compared to the prior year period, was further benefitted by the re-opening of economies while the prior year performance was negatively impacted by business closures related to the COVID-19 pandemic.

Geographically, we experienced growth in SMB net revenue across all three regions in the three and six months ended June 27, 2021, compared to the prior year periods.

SMB contribution income increased significantly for the three and six months ended June 27, 2021, compared to the prior year period, primarily due to higher net revenue and lower operating expenses as a proportion of net revenue, partially offset by higher freight costs as a proportion of net revenue.

Liquidity and Capital Resources

Our principal sources of liquidity are cash, cash equivalents, short-term investments and cash generated from operations. As of June 27, 2021, we had cash, cash equivalents and short-term investment of \$335.3 million, a decrease of \$18.0 million from December 31, 2020.

As of June 27, 2021, approximately 30% 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 27, 2021	June 28, 2020
	(In thousands)	
Cash provided by operating activities	\$ 8,510	\$ 92,170
Cash used in investing activities	(4,883)	(9,894)
Cash used in financing activities	(21,146)	(19,851)
Net cash increase (decrease)	<u>\$ (17,519)</u>	<u>\$ 62,425</u>

Operating activities

Net cash provided by operating activities decreased by \$83.7 million for the six months ended June 27, 2021, compared to the prior year period, primarily due to unfavorable working capital movements, partially offset by higher net income. The lower net cash inflow from working capital was mainly driven by higher inventory holding and higher payments to trade suppliers, partially offset by higher collection of account receivables and lower payments to other non-trade vendors. Inventory holding increased as we rebuilt inventory carrying levels to support ongoing demand and adjust for elongation of freight transit times.

Our Days Sales Outstanding (“DSO”) was 86 days as of June 27, 2021, consistent with 87 days as of December 31, 2020. Our accounts payable decreased from \$90.9 million as of December 31, 2020 to \$70.4 million as of June 27, 2021 due to timing of inventory receipts and supplier payments. Inventory increased from \$172.1 million as of December 31, 2020 to \$251.8 million as of June 27, 2021. Ending inventory turns were 3.4 in the three months ended June 27, 2021, down from 5.9 in the three months ended December 31, 2020.

Investing activities

Net cash used in investing activities decreased by \$5.0 million in the six months ended June 27, 2021, compared to the prior year period, mainly due to lower purchases of long-term investments.

Financing activities

The net change in net cash used in financing activities in the six months ended June 27, 2021, compared to the prior year period, was not material. The higher stock repurchase activity and increased payments relating to restricted stock unit tax withholdings were offset by increased proceeds from exercise of stock options.

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 27, 2021, 2.0 million shares remained authorized for repurchase under the repurchase program. During the six months ended June 27, 2021 and June 28, 2020, we repurchased and retired, reported based on trade date, approximately 0.7 million and 0.9 million shares of common stock, at a cost of approximately \$ 25.0 million and \$22.5 million, respectively, under the repurchase authorizations. We also repurchased and retired, reported based on trade date, approximately 154,000 and 149,000 shares of common stock, at a cost of approximately \$5.9 million and \$3.6 million during the six months ended June 27, 2021 and June 28, 2020, respectively, to administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving Restricted Stock Units. 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 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 27, 2021, from those as of December 31, 2020 disclosed in Part II, Item 7, of our Annual Report.

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. Commencing at the onset of the COVID-19 pandemic in March 2020, we experienced an elongation of the time from order placement to production primarily due to component shortages and supply chain disruptions. We have responded by extending our ordering horizon to as long as 18 months. We may become liable for non-cancellable material components, such as chipsets purchased by the supplier to meet our purchase order, even if it is subsequently cancelled. 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 27, 2021, we had approximately \$133.2 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. 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 27, 2021, we had approximately \$33.3 million in non-cancelable operating lease commitments. 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 14. 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 27, 2021, we did not have any off-balance-sheet arrangements as defined in Item 303(a)(4)(ii) of the Security and Exchange Commission's (the "SEC") Regulation S-K.

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 27, 2021, 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.

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 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 our 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 continuing to work 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*

Risk Factors Summary

The following is a summary of some of the risks and uncertainties as of the date of the filing of this Quarterly Report on Form 10-Q, some of which either have occurred or may occur in the future, that could materially adversely affect our business, financial condition and results of operations. You should read this summary together with the more detailed description of each risk factor contained below.

Risks Related to our Business, Industry and Operations

- The COVID-19 pandemic could materially adversely affect our financial condition and results of operations.
- We expect our operating results to fluctuate on a quarterly and annual basis.
- 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 obtain several key components from limited or sole sources.
- 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.
- We depend on a limited number of third-party manufacturers for substantially all of our manufacturing needs.
- 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.
- 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.
- 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.
- 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.
- 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.
- 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.
- 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.
- 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 sales and operations in international markets expose us to operational, financial and regulatory risks.
- As part of growing our business, we have made and expect to continue to make acquisitions.
- We invest in companies, but may not realize a return on our investments.
- Expansion of our operations and infrastructure may strain our operations and increase our operating expenses.

Risks Related to Our Products, Technology and Intellectual Property

- 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.
- 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 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.
- 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 user growth, engagement, and monetization of our subscription services on mobile devices depend upon effective operation with mobile operating systems, networks, technologies, products, and standards that we do not control.
- If we are unable to secure and protect our intellectual property rights, our ability to compete could be harmed.

Financial, Legal, Regulatory and Tax Compliance Risks

- Changes in tax laws or exposure to additional income tax liabilities could affect our future profitability.
- We are currently involved in numerous litigation matters and may in the future become involved in additional litigation.
- We are exposed to adverse currency exchange rate fluctuations.
- We could incur significant liability if the distribution of Arlo shares to our stockholders (the “Distribution”) is determined to be a taxable transaction.
- 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.
- We are subject to, and must remain in compliance with, numerous laws and governmental regulations.
- We are exposed to the credit risk of some of our customers and to credit exposures in weakened markets.
- If our goodwill and intangible assets become impaired we may be required to record a significant charge to earnings.

General Risk Factors

- Global economic conditions could materially adversely affect our revenue and results of operations.
- 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.
- Political events, war, terrorism, public health issues, natural disasters, sudden changes in trade and immigration policies, and other circumstances could materially adversely affect us.
- 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.
- Our stock price may be volatile and your investment in our common stock could suffer a decline in value.

Additional factors that could affect our businesses, results of operations and financial condition are discussed below. However, other factors not discussed below or elsewhere in this Quarterly Report on Form 10-Q could also adversely affect our businesses, results of operations and financial condition. Therefore, the risk factors below should not be considered a complete list of potential risks that we may face.

Any risk factor described in this Quarterly Report on Form 10-Q or in any of our other SEC filings could by itself, or together with other factors, materially adversely affect our liquidity, competitive position, business, reputation, results of operations, capital position or financial condition, including by materially increasing our expenses or decreasing our revenues, which could result in material losses.

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 16, 2021.*

Risks Related to our Business, Industry and Operations

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

The novel strain of the coronavirus (COVID-19) has spread as a global pandemic throughout the world 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 and its impact on overall global uncertainty; the level of vaccination rates; new and potentially more contagious or more dangerous variants of COVID-19, such as the delta variant; 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. For example, provinces in northern Vietnam where our factories and component suppliers are located implemented province-wide shutdowns during our most recently completed second fiscal quarter which materially adversely impacted our supply of SMB products and components during the quarter, and may continue to do so in future quarters. Further, as the availability of vaccines against the COVID-19 virus varies greatly around the world, the potential for future shutdowns which may adversely affect our ability to supply products remains a significant risk going forward. Similarly, current and future restrictions or disruptions of transportation, such as reduced availability of air and ground transport labor and vehicles, port closures or congestion, and increased border controls or closures, have impacted and may continue to 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. We have also experienced an increase in costs for ocean freight and shortages in freight capacity. This can negatively impact our ability to ship volume predictably and on a lower cost basis. 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. In particular, as vaccines have become widely available and consumers return to work or school and the impact of the COVID-19 pandemic subsides, particularly in North America where we derive a substantial portion of our revenue, we have started to see this increase in demand

begin to taper. If this tapering of demand occurs at a more rapid pace than we are forecasting, our revenue, profitability and other financial results could be adversely affected. This unanticipated increase in demand has also put strain on our manufacturing partners, suppliers and logistics partners to produce and deliver a sufficient number of products to meet this demand. In particular, the limited and delayed availability of certain key components for our products, such as specialized WiFi 6 chipsets, microcontrollers, power over ethernet chipsets and power integrated circuits, significantly constrains our ability to meet the increased demand and over the course of the past year, we have seen lead times for some of these key components increase dramatically from as low as 10 weeks to up to 50 weeks currently. This in turn puts pressure on our ability to accurately forecast and increases the likelihood that the accuracy of such forecasts will be lower, which could materially adversely affect our financial results. During the second and third fiscal quarters of 2020, we experienced a weakening in demand for our SMB products as businesses reacted to the uncertainty caused by the pandemic and placed projects on hold, and during our most recently completed second fiscal quarter we began to experience a softening in demand for our Connected Home products which was below our previous forecasts. If we continue to experience weakened demand in either our Connected Home or SMB business segments that is not in line with our forecasts, our revenue, profitability and other financial results would be materially adversely 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. The current severe economic slowdown resulting from the pandemic has already started to 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. For example, we have a significant research and development center in Bangalore, India, and significant vendor relationships with third party information technology and software development providers who are also based in India, which experienced a tremendous surge in COVID-19 cases during the first fiscal quarter of 2021. 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. As mentioned above, recent provincial shutdowns in northern Vietnam materially adversely affected our manufacturing partners and component suppliers in that area, which in turn materially adversely affected our supply chain and our operating results. Our main distribution partner in Southern California has had several incidents of workers at its facility testing positive for COVID-19, forcing the facility to close temporarily. Along the same lines, Amazon, one of our largest retail customers, shut down six warehouses in France in April due to a labor dispute with workers who alleged that Amazon wasn't doing enough to protect them from the ongoing COVID-19 pandemic. 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, as exemplified by the recent and rapid spread of the delta variant, and additional impacts and risks may arise that we are not aware of or able to appropriately respond to currently. Should the COVID-19 situation or global economic slowdown not improve or worsen, or if our attempts to mitigate its impact on our operations

and costs are not successful, our business, results of operations, financial condition and prospects may be adversely affected.

**** 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;
- operational disruptions, such as transportation delays or failure of our order processing system, particularly if they occur at the end of a fiscal quarter;
- component supply constraints, including specialized WiFi 6 chipsets, or sudden, unforeseen price increases from our manufacturers, suppliers and vendors;
- seasonal shifts in end market demand for our products, particularly in our Connected Home business segment;
- our inability to accurately forecast product demand, resulting in increased inventory exposure;
- unanticipated increases in costs, including air and ocean freight, associated with shipping and delivery of our products;
- the inability to maintain stable operations by our suppliers, distribution centers and other parties with which we have commercial relationships;
- 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;
- unanticipated decreases or delays in purchases of our products by our significant traditional and online retail customers;
- 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;
- an increase in price protection claims, redemptions of marketing rebates, product warranty and stock rotation returns or allowance for doubtful accounts;
- delay or failure to fulfill orders for our products on a timely basis;
- changes in the pricing policies of or the introduction of new products by us or our competitors;
- 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;
- 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;
- 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;
- changes in tax rates or adverse changes in tax laws that expose us to additional income tax liabilities;
- changes in U.S. and international trade policy that adversely affect customs, tax or duty rates;
- 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;
- delay or failure of our service provider customers to purchase at their historic volumes or at the volumes that they or we forecast;
- 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;
- disruptions or delays related to our financial and enterprise resource planning systems;
- 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;
- 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.

**** 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 and ocean 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. For example, a the COVID-19 outbreak at the port of Yantian in Shenzhen, China had a disruptive impact on our transportation network, including schedule changes, blank sailings and shipping delays.

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, pandemics like COVID-19 and congestion resulting from higher shipping volumes. For example, in March 2021, the Suez Canal, one of the world's busiest trading routes and a route through which we ship our products, was blocked in both directions for six days after the container ship Ever Given ran aground. This disrupted trade between Europe, the Middle East and Asia, causing delays for over 350 cargo ships carrying billions of dollars of products, including ours. Also, 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. For example, Amazon, one of our largest retail customers, shut down six warehouses in France in April due to a labor dispute with workers who alleged that Amazon wasn't doing enough to protect them from the ongoing COVID-19 pandemic. A port worker strike, work slow-down or other transportation disruption in the ports of Los Angeles or Long Beach, California, where we have a significant distribution center, could significantly disrupt our business. 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 been particularly acute in Southern California, where this distribution center is located. This has led to port congestion, temporary closures of the distribution center due to COVID-19 outbreaks, and difficulty in procuring ground transportation. If significant disruptions along these lines were to take place within the last few weeks of the quarter, this could lead to significant disruptions in our business, delays in shipments, and revenue and profitability shortfalls, which would materially adversely affect our business and financial results. 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. More recently, the cost of shipping our products by ocean freight have increased significantly and have had a corresponding impact upon our profitability. A prolonged transportation disruption or a significant increase in the cost of freight could severely disrupt our business and harm our operating results.

**** 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. 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 in sufficient quantities and in a timely manner. For example, we are currently experiencing chipset shortages for some of our switching products from two of our semiconductor suppliers who do not have enough supply to satisfy our demand, and this shortage may continue for the next several quarters. 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, and prices to obtain such components may increase. In addition, if worldwide demand for the components increases significantly, the availability of these components could be limited and prices for such components may increase. For example, as the demand for automobiles has increased significantly over the last fifteen months, our supplier of micro controller units, which are used in both automobile production and our power over ethernet switches, has been forced to prioritize supply to the automobile industry, leaving us short of supply on these key components and affecting our ability to produce enough power over ethernet switches to meet our forecasted demand in a timely manner. Further, dependence on a sole source for certain key components of our products may allow such sole source suppliers to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. As a result, we may be left with little choice but to accept such higher prices or other fees for key components in order to ensure continuity of supply. For example, we are currently experiencing price increases with certain suppliers and manufacturing partners, and are negotiating price increases with certain other suppliers and manufacturing partners. This could adversely affect our profitability or if we choose to push back against more onerous terms, could lead to inadequate supply, which could materially adversely affect our business. Our suppliers may also 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 and purchase orders, 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, which could be material. In fiscal 2020, we experienced an elongation of the time from order placement to production primarily due to component shortages and supply chain disruption brought about by the COVID-19 pandemic. We have responded by extending our ordering horizon to as long as 15 months. As a result, our exposure to the foregoing risks is greater and our potential liability for losses is greater relative to our more typical ordering horizon of up to 6 months.

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 are currently limiting our ability to supply all the worldwide demand for our SMB switch products, and our revenue has been and will continue to be 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 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. For example, demand for our Connected Home products for the 2021 fiscal year has turned out to be lower than we previously forecast, and will result in our revenue for the remainder of 2021 to come in lower than expected.

**** 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 revenue 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. 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, including the cost of components purchased by third-party manufacturers on our behalf, which may be material;
- 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, most recently in Southeast Asia and in particular northern Vietnam, where a significant portion of our products are manufactured. 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. For example, we are currently experiencing price increases with certain of our manufacturing partners, and are negotiating price increases with certain other of our manufacturing partners. Labor unrest in Southeast Asia, China or other locations where components and 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.

**** 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 and revenue.***

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), Linksys (owned by Foxconn), Nest (owned by Google), 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, SonicWall, Synology, TP-Link, Ubiquiti, and WatchGuard. 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, in the recent past certain network security companies such as Symantec have introduced security routers for the home consumer market to compete with us and we believe that other network security companies may also seek to do the same. 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, Eero by Amazon and Linksys by Foxconn. Additionally, in the case of Linksys, Foxconn is one of our main third party manufacturing partners, which presents an additional risk if Foxconn decides to prioritize its interest in Linksys over its relationship with us. 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.

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 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. Further, the COVID-19 pandemic has accelerated the shift to a greater percentage of purchases taking place online versus traditional retail customers. 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. Recently, we have begun to sell products and services directly to consumers from our own e-commerce platforms. This has required a material investment in capital, time and resources and carries the risk that it may not achieve the expected return on investment that we are expecting, and that it may adversely affect our relationships with our existing channel partners, which ultimately may materially adversely affect our results of operations.

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, such as sales directly to consumers from our own e-commerce platforms, our business could be harmed.

****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. Similarly, we have recently begun to sell products and services directly to consumers from our own e-commerce platforms. Some of our customers, such as Amazon and Best Buy, may consider this to be competitive with their own businesses, which could negatively influence their purchasing decisions with respect to our products. 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, and Amazon, one of our largest retail customers, shut down six warehouses in France in April due to a labor dispute with workers who alleged that Amazon wasn’t doing enough to protect them from the ongoing COVID-19 pandemic. 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. Further, we believe the COVID-19 pandemic has led to an acceleration of the shift to a greater percentage of products being bought and sold online. If we are unable to adjust to this shift, this may lead to lower market share and lower revenues for us, and our net revenue and operating results could be harmed.

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.

**** 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 prior U.S. administration altered the 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 engaged in extended trade negotiations with China, which resulted in the implementation of tariffs on a significant number of products manufactured in China and imported into the United States. There is no indication at this time that the current administration will amend or reverse the tariff policies enacted by the prior administration. We worked closely with our manufacturing partners to implement ways to mitigate the impact of these tariffs on our supply chain as promptly and reasonably as practicable, including shifting production outside of China. These efforts are disruptive on 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 revenue, 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.

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.

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 34% of overall net revenue in the second quarter of fiscal 2021 and approximately 31% of overall net revenue in fiscal 2020. 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 U.S. tariffs on certain imported products implemented by the U.S.);
- consequences of, and uncertainty related to, the "BREXIT" deal 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.

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 investments. For example, during fiscal year 2020, we have recognized impairment charges of \$6.2 million brought about by triggering events impacting the valuation of a number of our privately held long-term investments. 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.

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.

Risks Related to Our Products, Technology and Intellectual Property

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, but the threats to network and data security are increasingly diverse and sophisticated. Despite our efforts and processes to prevent breaches, our devices are potentially vulnerable to cybersecurity risks,

including cyber-attacks such as viruses and worms, vulnerabilities such as command injection, cross site scripting, authentication and session management, and stack-based buffer overflow, and other sophisticated attacks or exploits. It is also possible that an attacker could compromise our internal code repository or those of our partners and insert a 'backdoor' that would give them easy access to any of our devices using this code. This particular kind of attack is very sophisticated, relatively new, and hard to defend against. 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. These attacks could lead to interruptions, delays, loss of critical data, unauthorized access to user data, and loss of consumer confidence. If successful, these attacks could adversely affect our business, operating results, and financial condition, be expensive to remedy, and damage our reputation. In addition, any such breaches may result in negative publicity, adversely affect our brand, decrease demand for our products and services, and adversely affect our operating results and financial condition. Further, 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. On November 3, 2020, California passed the California Privacy Rights Act (CPRA), which will become effective on January 1, 2023. 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. The CPRA amends and augments the CCPA by expanding the rights of individuals and the obligations of businesses that handle personal data. California's privacy framework exemplifies the vulnerability of our business not only to cyber threats but also the evolving regulatory environment related to personal data. The CCPA and CPRA will likely 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.

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, profitability 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 output from these investments will successfully result in meaningful 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.

**** 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 revenue, 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. For example, we license software from Bitdefender for our NETGEAR Armor cybersecurity services offering and we license software from Circle Media Labs, Inc. for our parental controls service offering. 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 subscription service offerings related to network security and smart parental controls. 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 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.

****Our user growth, engagement, and monetization of our subscription services on mobile devices depend upon effective operation with mobile operating systems, networks, technologies, products, and standards that we do not control.***

The substantial majority of our revenue from our subscription services is generated from use of such services on mobile devices. We are dependent on the interoperability of Armor and our parental controls services and our other products with popular mobile operating systems, networks, technologies, products, and standards that we do not control, such as the Android and iOS operating systems and mobile browsers. Any changes, bugs, or technical issues in such systems, or changes in our relationships with mobile operating system partners, handset manufacturers, browser developers, or mobile carriers, or in their terms of service or policies that degrade our products' functionality, reduce or eliminate our ability to update or distribute our products, give preferential treatment to competitive products, or charge fees related to the distribution of our products could adversely affect the usage of our subscription services products or our other products on mobile devices. We may not be successful in maintaining or developing relationships with key participants in the mobile ecosystem or in developing products that operate effectively with these technologies, products, systems, networks, or standards. In the event that it is more difficult for our users to access and use our subscription services products or our other products on their mobile devices, or if our users choose not to access or use our subscription services products or our other products on their mobile devices, our user growth and user engagement and our business could be harmed.

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.

Financial, Legal, Regulatory and Tax Compliance Risks

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. For example, the new presidential administration may attempt to raise tax rates for U.S. corporations and has proposed a corporate tax rate of 28% in addition to other changes in U.S. tax law that would increase our U.S. tax burden. 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 continue to consider changes in their tax laws by implementing new taxes such as the digital service tax. In addition, the acceleration of employee mobility as a result of the pandemic potentially increases the jurisdictional tax risk of our workforce. Changes in tax laws could affect the distribution of our earnings, result in double taxation and adversely affect our results.

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.

The Company's U.S. federal tax return and payroll taxes for our fiscal year ended December 31, 2018 is currently under examination by the IRS. 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. If we do not prevail in any such disagreements, our profitability may be affected.

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. Recently, a third-party non-practicing entity initiated litigation against us in the United States International Trade Commission, which carries with it the threat of an injunction on the importation of our products into the United States, as well as a significant increase in time and resources to defend against. In addition, several third-party non-practicing entities have initiated litigation against us in China, which also raises novel and unique challenges for us. For example, thus far we have experienced that patent litigation in China proceeds along a faster timeline, is more costly than we anticipated, carries a greater risk of injunction, and suffers from a relative lack of judicial development relative to patent litigation in the United States. 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.

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.

We could incur significant liability if the distribution of Arlo shares to our stockholders is determined to be a taxable transaction.

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, after which 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”).

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. Our U.S. federal income tax return for the calendar year 2018, the year of the Distribution, is currently under audit by the IRS. 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.

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.

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 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, particularly with the election of a new presidential administration which has declared climate change a priority. 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 and intangible assets become impaired, we may be required to record a significant charge to earnings.

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 and 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 and intangible assets be determined resulting in an adverse impact on our results of operations.

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.

General Risk Factors

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. The current severe economic slowdown resulting from the pandemic has already started to 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 geopolitical 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" deal 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.

****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. Increasingly, the market for talent in the technology industry has become increasingly competitive, and we may not have the resources to compete at the same level as larger companies who are able to offer more compelling compensation packages. Further, changes brought about by the COVID-19 pandemic, for example being able to work from anywhere on a full-time basis, has led to an increase in employee mobility and employees are changing jobs at an increasing rate. Therefore, our ability to recruit new talent and retain existing talent may be adversely affected, and as a result our business as a whole may suffer. 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.

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. Southern California and California as a whole have also recently experienced one of the highest COVID-19 case rates in the world. Substantially all of our critical enterprise-wide information technology systems, including our main servers, are currently housed in colocation facilities in 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 previous 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 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.

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;
- novel and unforeseen market forces and trading strategies, such as the massive short squeeze rally caused by retail investors on companies such as Gamestop;
- 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 29, 2021 - April 25, 2021	484,420	\$ 38.01	482,797	2,153,505
April 26, 2021 - May 23, 2021	273,945	\$ 38.21	171,494	1,982,011
May 24, 2021 - June 27, 2021	1,871	\$ 38.88	—	1,982,011
Total	<u>760,236</u>	\$ 38.08	<u>654,291</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 27, 2021, we repurchased and retired, reported based on the trade date, approximately 0.7 million shares of common stock at a cost of approximately \$25.0 million under the authorizations.
- (2) During the three months ended June 27, 2021, we repurchased and retired, reported based on trade date, approximately 106,000 shares of common stock at a cost of approximately \$3.9 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	
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 30, 2021

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 30, 2021

/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 30, 2021

/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 27, 2021, 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 30, 2021

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 27, 2021, 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 30, 2021

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.