

NETGEAR, INC  
Form 10-K  
February 29, 2012  
Table of Contents

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form 10-K

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the fiscal year ended December 31, 2011

.. 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**  
*(I.R.S. Employer  
Identification No.)*

**95134**  
*(Zip Code)*

**Registrant's telephone number, including area code**

**(408) 907-8000**

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

## Edgar Filing: NETGEAR, INC - Form 10-K

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Stock, par value \$0.001	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

### **Securities registered pursuant to 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of July 3, 2011 was approximately \$905.9 million. Such aggregate market value was computed by reference to the closing price of the common stock as reported on the Nasdaq Global Select Market on July 1, 2011 (the last business day of the Registrant's most recently completed fiscal second quarter). Shares of common stock held by each executive officer and director and each entity that owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the registrant's Common Stock, \$0.001 par value, was 37,803,236 shares as of February 21, 2012.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Registrant's 2012 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	11
Item 1B. <u>Unresolved Staff Comments</u>	33
Item 2. <u>Properties</u>	33
Item 3. <u>Legal Proceedings</u>	33
Item 4. <u>Mine Safety Disclosures</u>	33
<b><u>PART II</u></b>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	34
Item 6. <u>Selected Consolidated Financial Data</u>	36
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	38
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	55
Item 8. <u>Consolidated Financial Statements and Supplementary Data</u>	56
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	109
Item 9A. <u>Controls and Procedures</u>	109
Item 9B. <u>Other Information</u>	110
<b><u>PART III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	111
Item 11. <u>Executive Compensation</u>	111
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	111
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	111
Item 14. <u>Principal Accounting Fees and Services</u>	111
<b><u>PART IV</u></b>	
Item 15. <u>Exhibits and Financial Statement Schedule</u>	112
<u>Signatures</u>	113
<u>Index to Exhibits</u>	114

---

**Table of Contents**

**PART I**

This Annual Report on Form 10-K ( *Form 10-K* ), including Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 below, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the *Exchange Act* ). All statements other than statements of historical facts contained in this Form 10-K, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words believe, may, will, estimate, continue, anticipate, intend, should, plan, expect and similar expressions, as they relate to us, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions described in *Risk Factors* in Part I, Item 1A below, and elsewhere in this Form 10-K, including, among other things: the future growth of the commercial business, retail, and broadband service provider markets; speed of adoption of wireless networking worldwide; our business strategies and development plans; our successful introduction of new products and technologies; future operating expenses and financing requirements; and competition and competitive factors in the commercial business, retail, and broadband service provider markets. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Form 10-K may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. All forward-looking statements in this Form 10-K are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements. The following discussion should be read in conjunction with our consolidated financial statements and the accompanying notes contained in this Form 10-K.

**Item 1. *Business***  
**General**

We are a global networking company that delivers innovative products to consumers, businesses and service providers. In the second fiscal quarter of 2011, we made organizational changes that we believe enable us to better focus our efforts on core customer segments and allow us to be more nimble and opportunistic as a company overall. Our business is now managed in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home networking, storage and digital media products to connect users with the Internet and their content and devices. The commercial business unit consists of business networking, storage and security solutions without the cost and complexity of Big IT. The service provider business unit consists of made-to-order and retail proven, whole home networking solutions sold to service providers for sale to their customers. Additionally, in the first fiscal quarter of 2011, we combined our North American, Central American and South American sales forces to form the Americas territory. Previously, North America was its own geographic region and the Central American and South American territories were categorized within the Asia Pacific ( *APAC* ) geographic region. Following this change, we are now organized into the following three geographic territories: Americas, Europe, Middle-East and Africa ( *EMEA* ) and APAC. For further detail, refer to Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

We were incorporated in Delaware on January 8, 1996. Our principal executive offices are located at 350 East Plumeria Drive, San Jose, California 95134, and our telephone number at that location is (408) 907-8000. Our website address is [www.netgear.com](http://www.netgear.com).

In the years ended December 31, 2011, 2010, and 2009, we generated net revenue of \$1.18 billion, \$902.1 million, and \$686.6 million, respectively.

## **Table of Contents**

### **Markets**

Our goal is to be the leading provider of innovative networking products to the consumer, business, and service provider markets. A number of factors are driving today's demand for networking products within these markets. As the number of computing devices, such as PCs, smart phones and tablet computers, has increased in recent years, networks—especially WiFi networks—are being deployed more broadly in order to share information and resources among users and devices. This information and resource sharing occurs internally, through a local area network, or externally, via the Internet. To take advantage of complex applications, advanced communication capabilities and rich multimedia content, users are upgrading their Internet connections by deploying high-speed broadband access technologies. Users also seek the convenience and flexibility of operating their PCs, laptops, smart phones, tablet computers and related computing devices while accessing their content in a more mobile, or wireless, manner. In addition, market demand for television connectivity products has increased significantly as well, where users seek to connect their televisions to the Internet and for entertainment content. Finally, as the usage of networks, including the Internet, has increased, users have become much more focused on the security of their connections and the protection of the data within their networks.

Consumers, businesses and service providers demand a complete set of wired and wireless networking and broadband products that are tailored to their specific needs and budgets and also incorporate the latest networking technologies. These users require the continual introduction of new and refined products and often lack extensive IT resources and technical knowledge. Therefore, they demand plug-and-play or easy-to-install and use products that require little or no maintenance, and customer service and support. We believe that these users also prefer the convenience of obtaining a networking solution from a single company with whom they are familiar; as these users expand their networks, they tend to be loyal purchasers of that brand. In addition, purchasing decisions of users in these markets are also driven by the affordability of networking products. To provide reliable, easy-to-use products at an attractive price, we believe a successful supplier must have a company-wide focus on the unique requirements of these markets, operational discipline and cost-efficient infrastructure and processes that allow for efficient product development, manufacturing and distribution.

### **Sales Channels**

We sell our products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers ( DMRs ), value-added resellers ( VARs ), and broadband service providers.

*Wholesale Distribution.* Our distribution channel supplies our products to retailers, e-commerce resellers, Direct Market Resellers and Value Added Resellers. We sell directly to our distributors, the largest of which are Ingram Micro, Inc. and Tech Data Corporation.

*Retailers.* Our retail channel primarily supplies products that are sold into the consumer market. We sell directly to, or enter into consignment arrangements with, a number of our traditional retailers. The remaining traditional retailers, as well as our online retailers, are fulfilled through wholesale distributors. We work directly with our retail channels on market development activities, such as co-advertising, in-store promotions and demonstrations, instant rebate programs, event sponsorship and sales associate training, as well as establishing store within a store websites and banner advertising.

*DMRs and VARs.* We primarily sell into the commercial business marketplace through an extensive network of DMRs and VARs. Our DMRs include companies such as CDW and Insight. VARs include our network of registered Powershift Partners, and resellers that are not registered in our Powershift partner program. DMRs and VARs may receive sales incentives, marketing support and other program benefits from us. Our DMRs and VARs generally purchase our products through our wholesale distributors.

*Broadband Service Providers.* We also supply our products directly to broadband service providers in the United States and internationally. Service providers supply our products to their business and home subscribers.

## **Table of Contents**

The largest portion of our net revenues was derived from Americas sales in the year ended December 31, 2011. The Americas sales as a percentage of net revenue decreased from 51.7% in the year ended December 31, 2010 to 49.7% in the year ended December 31, 2011. We have committed resources to expanding our international operations and sales channels. Accordingly, we are subject to a number of risks related to international operations such as macroeconomic and microeconomic conditions, geopolitical instability, preference for locally branded products, exchange rate fluctuations, increased difficulty in managing inventory, challenges of staffing and managing foreign operations, the effect of international sales on our tax structure, and changes in local tax laws. See Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for further discussion of net revenues by geographic region.

Retail company Best Buy, Inc. and distributor Ingram Micro, Inc. each accounted for 10% or greater of our net revenues in the years ended December 31, 2011, 2010 and 2009. See Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for further details on customer concentrations.

## **Product Offerings**

Our product line consists of wired and wireless devices, including devices that enable commercial business networking, broadband access, network connectivity, network storage and security appliances. These products are available in multiple configurations to address the needs of our customers in each geographic region in which our products are sold.

*Commercial business networking.* These products include:

Ethernet switches, which are multiple port devices used to network PCs and peripherals via Ethernet wiring;

Wireless controllers, which are devices used to manage and control multiple WiFi base stations which in turn provide WiFi connections to PCs and peripherals;

Internet Security Appliances, which provide Internet access through capabilities such as anti-virus and anti-spam; and

network attached storage, which enables file sharing among multiple PCs and other networked devices over a local area network.  
*Broadband access.* Broadband is a transmission medium capable of moving more digital content over public high speed networks than traditional low speed telephone lines. Products that enable broadband access include:

routers, which connect the home or office networks to the Internet via broadband modems;

gateways, which are routers with integrated modems, for Internet access;

IP telephony products, used for transmitting voice communications over a network; and

Media servers, which store files and multimedia content for access by PCs, laptops, smart phones and other Internet enabled devices.  
*Network connectivity.* Products that enable network connectivity and resource sharing include:

## Edgar Filing: NETGEAR, INC - Form 10-K

wireless access points and range extenders, which provide a wireless link between a wired network and wireless devices;

wireless network interface cards and adapters, which enable devices to be connected to the network wirelessly;

Ethernet network interface cards and adapters, which enable devices to be connected to the network over Ethernet wiring;

---

## **Table of Contents**

media adapters, which connect non PC entertainment devices such as TVs, audio players, and game consoles to a network;

powerline adapters and bridges, which enable devices to be connected to the network over existing electrical wiring; and

Multimedia over Coax Alliance standard ( MoCA ) adapters and bridges, which enable devices to be connected to the network over existing coaxial wiring.

We design our products to meet the specific needs of the consumer, business and service provider markets, tailoring various elements of the product design, including component specification, physical characteristics such as casing, design and coloration, and specific user interface features to meet the needs of these markets. We also leverage many of our technological developments, high volume manufacturing, technical support and engineering infrastructure across our markets to maximize business efficiencies.

Our products that target the business market are generally designed with an industrial appearance, including metal cases and, for some product categories, the ability to mount the product within standard data networking racks. These products typically include higher port counts, higher data transfer rates and other performance characteristics designed to meet the needs of a commercial business user. For example, we offer data transfer rates up to ten Gigabits per second for our business products to meet the higher capacity requirements of business users. Some of these products are also designed to support transmission modes such as fiber optic cabling, which is common in more sophisticated business environments. Security requirements within our products for commercial business broadband access include firewall, virtual private network and content threat management capabilities that allow for secure interactions between remote offices and business headquarter locations over the Internet. Our connectivity product offerings for the commercial business market include enhanced security and remote configurability often required in a business setting. Our ReadyNAS<sup>®</sup> family of network attached storage products implements redundant array of independent disks data protection, enabling businesses to store and protect critical data easily, efficiently and intelligently.

Our products for the consumer and service provider markets are generally designed with pleasing visual and physical aesthetics that are more desirable in a home environment. Our connectivity offerings for the consumer market are generally at a lower price than higher security and configurability wireless offerings for the business market. Our products for facilitating broadband access in the home are available with features such as parental control capabilities and firewall security, to allow for safer, more controlled Internet usage in families with children. Our broadband products designed for the home market also contain installation software that guides a less sophisticated user through the installation process with their broadband service provider, using a graphical user interface and simple point and click operations. Our connectivity product offerings for the consumer market include powerline and MoCA data transmission modes, which allow home users to take advantage of their existing electrical or coaxial wiring infrastructure for transmitting data among network components.

Our vision for the home network has always been about having all devices connected to the Internet at all times. Recently, our focus has been to continue to introduce new products into what we believe are five new growth areas: First, TV connectivity products such as our new Push2TV HD edition announced jointly with Intel at the 2011 International Consumer Electronics Show; Second, network attached storage products with enhanced user interfaces, higher capacity and resilience; Third, security appliances that support more users; Fourth, DOCSIS 3.0 gateways with more integrated functions; and Fifth, the 4G/Long Term Evolution ( LTE ) related repeaters and routers. We continue to announce and introduce new products in these significant growth markets.

## **Competition**

The consumer, business and service provider markets are intensely competitive and subject to rapid technological change. We expect competition to continue to intensify. Our principal competitors include:

within the consumer markets, companies such as Apple, Belkin, D-Link, the Linksys division of Cisco Systems, Roku and Western Digital; and



## **Table of Contents**

within the business markets, companies such as Allied Telesys, Barracuda, Buffalo, Data Robotics, Dell, D-Link, Fortinet, Hewlett-Packard, Huawei, Cisco Systems, the Linksys division of Cisco Systems, QNAP Systems, Seagate Technology, SonicWALL, Synology, WatchGuard and Western Digital; and

within the service provider markets, companies such as Actiontec, ARRIS, Comtrend, D-Link, Hitron, Huawei, Motorola, Pace, Sagem, Scientific Atlanta-a Cisco company, SMC Networks, TechniColor, Ubee, Compal Broadband, ZTE and ZyXEL .

Other current and potential competitors include numerous local vendors such as Devolo, LEA and AVM in Europe, Corega and Melco in Japan and TP-Link in China. Our potential competitors also include other consumer electronics vendors, including LG Electronics, Microsoft, Panasonic, Samsung, 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 are 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 ODM s, 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. As a result, they may have more advanced technology, larger distribution channels, stronger brand names, better customer service and access to more customers than we do. For example, Hewlett-Packard has significant brand name recognition and has an advertising presence substantially greater than ours. Similarly, Cisco Systems is well recognized as a leader in providing networking products to businesses and has substantially greater financial resources than we do. Several of our competitors, such as the Linksys division of Cisco Systems and D-Link, offer a range of products that directly compete with most of our product offerings. Several of our other competitors primarily compete in a more limited manner. For example, Hewlett-Packard sells networking products primarily targeted at larger businesses or enterprises. However, the competitive environment in which we operate changes rapidly. Other large companies with significant resources could become direct competitors, either through acquiring a competitor or through internal efforts.

We believe that the principal competitive factors in the consumer, business and service provider markets for networking products include product breadth, size and scope of the sales channel, brand name, timeliness of new product introductions, product availability, performance, features, functionality and reliability, price, ease-of-installation, maintenance and use, and customer service and support. We believe our products are competitive in these markets based on these factors.

To remain competitive, we believe we must invest significant resources in developing new products and enhancing our current products while continuing to expand our sales channels and maintaining customer satisfaction worldwide.

## **Research and Development**

As of December 31, 2011, we had 224 employees engaged in research and development. We believe that our success depends on our ability to develop products that meet changing user needs and to anticipate and proactively respond to evolving technology in a timely and cost-effective manner. Accordingly, we have made investments in our research and development department in order to effectively evaluate new third-party technologies, develop new in-house technologies, and develop and test new products. Our research and development employees work closely with our technology and manufacturing partners to bring our products to market in a timely, high quality and cost-efficient manner.

---

## **Table of Contents**

We identify, qualify or self-develop new technologies, and we work closely with our various technology suppliers and manufacturing partners to develop products using one or more of the development methodologies described below.

*ODM.* Under the original design manufacturer ( ODM ), methodology, we define the product concept and specification and recommend the technology selection. We then coordinate with our technology suppliers while they develop the product meeting our specification. On certain new products, one or more subsystems of the design can be done in-house and then integrated in with the remaining design pieces from the ODM. Once prototypes are completed, we work with our partners to complete the debugging and systems integration and testing. After completion of the final tests, agency approvals and product documentation, the product is released for production.

*In-House Development.* Under the in-house development model, one or more subsystems of the product are designed and developed utilizing the NETGEAR engineering team. Under this model, some of the primary technology is developed in-house. We then work closely with either an ODM or a contract manufacturer to complete the development of the entire design, perform the necessary testing, and obtain regulatory approvals before the product is released for production.

*OEM.* Under the original equipment manufacturer ( OEM ), methodology, which we use for a limited number of products, we define the product specification and then purchase the product from OEM suppliers that have existing products fitting our design requirements. In some cases, once a technology supplier's product is selected, we work with the OEM supplier to complete the cosmetic changes to fit into our mechanical and packaging design, as well as our documentation and graphical user interface ( GUI ), standard. The OEM supplier completes regulatory approvals on our behalf. When all design verification and regulatory testing is completed, the product is released for production.

Our internal research and development efforts focus on developing and improving the usability, reliability, functionality, cost and performance of our products. Our total research and development expenses were \$48.7 million in 2011, \$40.0 million in 2010 and \$30.1 million in 2009.

## **Manufacturing**

Our primary manufacturers are Cameo Communications Inc., Delta Networks Incorporated, Hon Hai Precision Industry Co., Ltd. (more commonly known as Foxconn Corporation), SerComm Corporation, and Unihan Corporation (which was spun out of ASUSTek Computer, Inc. in January 2008), all of which are headquartered in Taiwan. The actual manufacturing of our products occurs primarily in mainland China and Vietnam, with pilot and low-volume manufacturing in Taiwan on a select basis. We distribute our manufacturing among these key suppliers to avoid excessive concentration with a single supplier. Because substantially all of our manufacturing occurs in mainland China and Vietnam, any disruptions from natural disasters, health epidemics and political, social and economic instability would affect the ability of our ODMs to manufacture our products. In addition, our ODMs in China have continued to increase our costs of production, particularly in the recent year. These increased costs have affected our margins and ability to lower prices for our products to stay competitive. If our manufacturers or warehousing facilities are disrupted or destroyed, we would have no other readily available alternatives for manufacturing our products and our business would be significantly impacted. In addition to their responsibility for the manufacturing of our products, our manufacturers purchase all necessary parts and materials to produce complete, finished goods. To maintain quality standards for our suppliers, we have established our own product quality organization based in Hong Kong and mainland China. They are responsible for auditing and inspecting process and product quality on the premises of our ODMs and OEMs.

We obtain several key components from limited or sole sources. For example, many of the semiconductors and meta materials used in our products are 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

## **Table of Contents**

from limited sources. These components include connector jacks, plastic casings and physical layer transceivers. We also obtain switching fabric semiconductors, which are used in our Ethernet switches and Internet gateway products, and wireless local area network chipsets, which are used in all of our wireless products, from a limited number of suppliers. Our third party manufacturers generally purchase these components on our behalf on a purchase order basis. If these sources fail to satisfy our supply requirements, our ability to meet scheduled product deliveries would be harmed and we may lose sales and experience increased component costs.

We currently outsource warehousing and distribution logistics to five main third-party providers who are responsible for warehousing, distribution logistics and order fulfillment. In addition, these parties are also responsible for some configuration and re-packaging of our products including bundling components to form kits, inserting appropriate documentation, disk drive configuration, and adding power adapters. APL Logistics Americas, Ltd. in City of Industry, California serves the Americas region, Kerry Logistics Ltd. in Hong Kong serves the Asia Pacific region, DSV Solutions B.V. and ModusLink B.V. in the Netherlands serve the EMEA, region and Agility Logistics Pty Ltd. in Matraville, NSW, Australia which serves Australia and New Zealand.

## **Sales and Marketing**

As of December 31, 2011, we had 357 employees engaged in sales and marketing. We work directly with our customers on market development activities, such as co-advertising, in-store promotions and demonstrations, instant rebate programs, event sponsorship and sales associate training. We also participate in major industry trade shows and marketing events. Our marketing department is comprised of our product marketing and corporate marketing groups.

Our product marketing group focuses on product strategy, product development roadmaps, the new product introduction process, product lifecycle management, demand assessment and competitive analysis. The group works closely with our sales and research and development groups to align our product development roadmap to meet customer technology demands from a strategic perspective. The group also ensures that product development activities, product launches, channel marketing program activities, and ongoing demand and supply planning occur in a well-managed, timely basis in coordination with our development, manufacturing, and sales groups, as well as our ODM, OEM and sales channel partners.

Our corporate marketing group is responsible for defining and building our corporate brand. The group focuses on defining our mission, brand promise and marketing messages on a worldwide basis. This group also defines the marketing approaches in the areas of advertising, public relations, events, channel programs and our web delivery mechanisms. These marketing messages and approaches are customized for the commercial business, home user, and broadband service provider markets through a variety of delivery mechanisms designed to effectively reach end-users in a cost-efficient manner.

We conduct most of our international sales and marketing operations through wholly-owned subsidiaries which operate via sales and marketing subsidiaries and branch offices worldwide.

## **Customer Support**

We design our products with plug and play ease of use. We respond globally to customer questions through a variety of venues including phone, chat and email. Customers can also get self-help service through the comprehensive knowledgebase and the user forum on our website. Customer support is provided through a combination of a limited number of permanent employees and use of subcontracted, out-sourced resources. Our permanent employees design our technical support database and are responsible for training and managing our outsourced sub-contractors. They also handle escalations from the outsourced resources. We utilize the information gained from customers by our customer support organization to enhance our product offerings, including further simplifying the installation process.

## **Table of Contents**

### **Intellectual Property**

We believe that our continued success will depend primarily on the technical expertise, speed of technology implementation, creative skills and management abilities of our officers and key employees, plus ownership of a limited but important set of copyrights, trademarks, trade secrets and patents. We primarily rely on a combination of copyright, trademark and trade secret and patent laws, nondisclosure agreements with employees, consultants and suppliers and other contractual provisions to establish, maintain and protect our proprietary rights. We hold 43 issued United States patents that expire between years 2013 and 2028 and 19 foreign patents that expire between 2012 and 2026. In addition, we currently have a number of pending United States and foreign patent applications related to technology and products offered by us. We also rely on third-party licensors for patented hardware and software license rights in technology that are incorporated into and are necessary for the operation and functionality of our products. Our success will depend in part on our continued ability to have access to these technologies.

We have trade secret rights for our products, consisting mainly of product design, technical product documentation and software. We also own, or have applied for registration of trademarks, in connection with our products in the United States and internationally, including NETGEAR, the NETGEAR logo, NETGEAR Green, the NETGEAR Green logo, NETGEAR Digital Entertainer, the NETGEAR Digital Entertainer logo, Genie, the Genie logo, Readyshare, Neo TV, the Neo TV logo, NETGEAR Stora, the NETGEAR Stora logo, Connect with Innovation, ProSafe, RangeMax, ReadyNAS, Smart Wizard, ProSecure, the ProSecure logo, Push2TV, Ultraline, Proline, Liteline, Envoy Service Management System, Versalink, Wirespeed, Leaf Networks, and X-RAID. We have registered a number of Internet domain names that we use for electronic interaction with our customers including dissemination of product information, marketing programs, product registration, sales activities, and other commercial uses.

### **Seasonal Business**

We have historically experienced increased net sales in our third and fourth fiscal quarters as compared to other quarters in our fiscal year due to seasonal demand of consumer markets related to the beginning of the school year and the holiday season. However, because of irregular and significant purchases from customers in other markets, such as the service provider market, this pattern has not been consistent. As such, any pattern should not be considered a reliable indicator of our future net sales or financial performance.

### **Backlog**

We believe the actual amount of product backlog at any particular time is not a meaningful indication of our future business. Our backlog consists of products for which customer purchase orders have been received and that are scheduled or in the process of being scheduled for shipment. While we expect to fulfill the order backlog within the current year, most orders are subject to rescheduling or cancellation with little or no penalties. Because of the possibility of customer changes in product scheduling or order cancellation, our backlog as of any particular date may not be an indicator of net sales for any subsequent period. Accordingly, backlog should not be considered a reliable indicator of our ability to achieve any particular level of revenue or financial performance.

### **Environmental Laws**

Our products and manufacturing process are subject to numerous governmental regulations, which cover both the use of various materials as well as environmental concerns. Environmental issues such as pollution and climate change have had significant legislative and regulatory efforts on a global basis, and there are expected to be additional changes to the regulations in these areas. 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. Other regulations in the environmental area may require us to continue to monitor and ensure

## **Table of Contents**

proper disposal or recycling of our products. To the best of our knowledge, we maintain compliance with all current government regulations concerning our production processes, for all locations in which we operate. Since we operate on a global basis, this is also 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.

### **Employees**

As of December 31, 2011, we had 791 full-time employees, with 357 in sales, marketing and technical support, 224 in research and development, 96 in operations, and 114 in finance, information systems and administration. We also utilize a number of temporary staff to supplement our workforce. We have never had a work stoppage among our employees and no personnel are represented under collective bargaining agreements.

Long-lived assets by geographic location are listed under Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, which information is incorporated into this Item 1 by reference.

### **Available Information**

We file reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, in accordance with the Exchange Act. You may read and copy our reports, proxy statements and other information filed by us at the SEC's Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. Our filings are also available to the public over the Internet at the SEC's website at <http://www.sec.gov>.

Our website provides a link to our SEC filings, which are available on the same day such filings are made. The specific location on the website where these reports can be found is <http://investor.netgear.com/sec.cfm>. Our website also provides a link to Section 16 filings which are available on the same day as such filings are made. Information contained on these websites is not a part of this Form 10-K.

### **Executive Officers of the Registrant**

The following table sets forth the names, ages and positions of our executive officers as of February 7, 2012.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Patrick C.S. Lo	55	Chairman and Chief Executive Officer
Christine M. Gorjanc	55	Chief Financial Officer
Mark G. Merrill	57	Chief Technical Officer
Shane J. Buckley	44	Senior Vice President and General Manager of Commercial Business Unit
Michael P. Clegg	51	Senior Vice President and General Manager of Service Provider Business Unit
David S.G. Soares	45	Senior Vice President and General Manager of Retail Business Unit
Michael F. Falcon	55	Senior Vice President of Worldwide Operations and Support
Charles T. Olson	56	Senior Vice President of Engineering
Andrew W. Kim	41	Vice President, Legal and Corporate Development, Corporate Secretary

*Patrick C.S. Lo* is our co-founder and has served as our Chairman and Chief Executive Officer since March 2002. Patrick founded NETGEAR with Mark G. Merrill with the singular vision of providing the appliances to enable everyone in the world to connect to the high speed Internet for information, communication, business transactions, education, and entertainment. From 1983 until 1995, Mr. Lo worked at Hewlett-Packard Company,

---

**Table of Contents**

where he served in various management positions in sales, technical support, product management, and marketing in the U.S. and Asia. Mr. Lo was named the Ernst & Young National Technology Entrepreneur of the Year in 2006. Mr. Lo received a B.S. degree in electrical engineering from Brown University.

*Christine M. Gorjanc* has served as our Chief Financial Officer since January 2008, Chief Accounting Officer from December 2006 to January 2008 and Vice President, Finance from November 2005 to December 2006. From September 1996 through November 2005, Ms. Gorjanc served as Vice President, Controller, Treasurer and Assistant Secretary for Aspect Communications Corporation, a provider of workforce and customer management solutions. From October 1988 through September 1996, Ms. Gorjanc served as the Manager of Tax for Tandem Computers, Inc., a provider of fault-tolerant computer systems. Prior to that, Ms. Gorjanc served in management positions at Xidex Corporation, a manufacturer of storage devices, and spent eight years in public accounting with a number of accounting firms. Ms. Gorjanc holds a B.A. in Accounting (with honors) from the University of Texas at El Paso and a M.S. in Taxation from Golden Gate University.

*Mark G. Merrill* is our co-founder and has served as our Chief Technology Officer since January 2003. From September 1999 to January 2003, he served as Vice President of Engineering and served as Director of Engineering from September 1995 to September 1999. From 1987 to 1995, Mr. Merrill worked at SynOptics Communications, a local area networking company, which later merged with Wellfleet to become Bay Networks, where his responsibilities included system design and analog implementations for SynOptics first 10BASE-T products. Mr. Merrill received both a B.S. degree and an M.S. degree in Electrical Engineering from Stanford University.

*Shane J. Buckley* has served as our Senior Vice President and General Manager of Commercial Business since April 2011, and Senior Vice President and General Manager Small/Medium Business from October 2009 to March 2011. Prior to joining us, Mr. Buckley served as President & CEO of Rohati Systems from November 2007 to October 2009, COO of Aviram Networks, Inc. (formerly Nevis Networks) from July 2006 to November 2007, Vice President WW Enterprise at Juniper Networks from June 2005 to April 2006, President International at Peribit Networks from February 2002 to July 2005, CEO at Conduit Software from December 2000 to February 2002, and EMEA Vice President at 3Com Corp from 1998 to 2000. Mr. Buckley holds a B.S. Degree in Engineering from the Cork Institute of Technology in Ireland.

*Michael P. Clegg* has served as our Senior Vice President and General Manager of Service Provider Business since August 2005. Prior to joining NETGEAR, Mr. Clegg served as VP Engineering, at Entrisphere (now part of Ericsson) from February 2003 to January 2005, and COO and CTO at Virtual Access from September 1999 to April 2002. From March 1999 to September 1999, Mr. Clegg served as Vice President DSL Solutions at Fujitsu Telecommunications Europe which acquired the Westell Europe subsidiary, which Mr. Clegg led as Managing Director from May 1995 to September 1999. Prior to May 1995, Mr. Clegg served as Senior Consultant at Scientific Generics (now Sagentia) from December 1989 to April 1994. Mr. Clegg received both a B.S. degree in Electrical Engineering and an M.S. degree in Digital Systems Design from the University of the Witwatersrand, South Africa.

*David S.G. Soares* has served as our Senior Vice President and General Manager of Retail Business Unit since April 2011, and Senior Vice President of Worldwide Sales from August 2004 to March 2011. Mr. Soares joined us in January 1998, and served as Vice President of EMEA sales from December 2003 to July 2004, EMEA Managing Director from April 2000 to November 2003, United Kingdom and Nordic Regional Manager from February 1999 to March 2000 and United Kingdom Country Manager from January 1998 to January 1999. Prior to joining us, Mr. Soares was at Hayes Microcomputer Products, a manufacturer of dial-up modems, where he was head of their retail, e-commerce and DMR channels in the UK. Mr. Soares attended Ridley College, Ontario Canada.

*Michael F. Falcon* has served as our Senior Vice President of Worldwide Operations and Support since January 2009, Senior Vice President of Operations from March 2006 to January 2009, and Vice President of Operations from November 2002 to March 2006. Prior to joining us, Mr. Falcon was at Quantum Corporation, where he served as Vice President of Operations and Supply Chain Management from September 1999 to

---

## **Table of Contents**

November 2002, Meridian Data (acquired by Quantum Corporation), where he served as Vice President of Operations from April 1999 to September 1999, and Silicon Valley Group, where he served as Director of Operations, Strategic Planning and Supply Chain Management from February 1989 to April 1999. Prior to February 1989, Mr. Falcon served in management positions at SCI Systems, an electronics manufacturer, Xerox Imaging Systems, a provider of scanning and text recognition solutions, and Plantronics, Inc., a provider of lightweight communication headsets. Mr. Falcon received a B.A. degree in Economics with honors from the University of California, Santa Cruz and has completed coursework in the M.B.A. program at Santa Clara University.

*Charles T. Olson* has served as our Senior Vice President of Engineering since March 2006 and our Vice President of Engineering from January 2003 to March 2006. Prior to joining NETGEAR, Mr. Olson was at Hewlett-Packard Company, from July 1978 to January 2003, where he served as Director of Research and Development for ProCurve networking from 1998 to 2003, as Research and Development Manager for the Enterprise Netserver division from 1997 to 1998, and, in various other engineering management roles in Hewlett-Packard's Unix server and personal computer product divisions prior to 1998. Mr. Olson received a B.S. degree in Electrical Engineering from the University of California, Davis and an M.B.A. from Santa Clara University.

*Andrew W. Kim* has served as our Vice President, Legal and Corporate Development and Corporate Secretary since October 2008 and as our Associate General Counsel from March 2008 to October 2008. Prior to joining NETGEAR, Mr. Kim served as Special Counsel in the Corporate and Securities Department of Wilson Sonsini Goodrich & Rosati, a private law firm, where he represented public and private technology companies in a wide range of matters, including mergers and acquisitions, debt and equity financing arrangements, securities law compliance and corporate governance from 2000 to 2003 and 2006 to 2008. In between his two terms at Wilson Sonsini Goodrich & Rosati, Mr. Kim served as Partner in the Business and Finance Department of the law firm Schwartz Cooper Chartered in Chicago, Illinois, and was an Adjunct Professor of Entrepreneurship at the Illinois Institute of Technology. Mr. Kim holds a J.D. from Cornell Law School, and received a B.A. degree in history from Yale University.

### **Item 1A. Risk Factors**

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

#### **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:

changes in the pricing policies of or the introduction of new products by us or our competitors;

unanticipated shift or decline in profit by geographical region that would adversely impact our tax rate;

slow or negative growth in the networking product, personal computer, Internet infrastructure, home electronics and related technology markets, as well as decreased demand for Internet access;

**Table of Contents**

operational disruptions, such as transportation delays or failure of our order processing system, particularly if they occur at the end of a fiscal quarter;

geopolitical disruption leading to delay or even stoppage of our operations in manufacturing, transportation, technical support and research and development;

delay or failure of our service provider customers to purchase at the volumes that they forecast;

foreign currency exchange rate fluctuations in the jurisdictions where we transact sales and expenditures in local currency;

changes in or consolidation of our sales channels and wholesale distributor relationships or failure to manage our sales channel inventory and warehousing requirements;

delay or failure to fulfill orders for our products on a timely basis;

allowance for bad debts exposure with our existing customers and new customers, particularly as we expand into new international markets;

disruptions or delays related to our financial and enterprise resource planning systems;

our inability to accurately forecast product demand;

component supply constraints from our vendors;

unfavorable level of inventory and turns;

unanticipated shift in overall product mix from higher to lower margin products that would adversely impact our margins;

terms of our contracts with customers or suppliers that cause us to incur additional expenses or assume additional liabilities;

the inability to maintain stable operations by our suppliers and other parties with which we have commercial relationships;

delays in the introduction of new products by us or market acceptance of these products;

an increase in price protection claims, redemptions of marketing rebates, product warranty and stock rotation returns or allowance for doubtful accounts;



## Edgar Filing: NETGEAR, INC - Form 10-K

litigation involving patent infringement;

epidemic or widespread product failure, or unanticipated safety issues, in one or more of our products;

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 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;

unanticipated increase in costs, including air freight, associated with shipping and delivery of our products;

our failure to implement and maintain the appropriate internal controls over financial reporting which may result in restatements of our financial statements; and

any changes in accounting rules.

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.

---

**Table of Contents**

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

With the continuing uncertainty about economic conditions in Europe, the United States and elsewhere internationally, 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 stabilize currencies;

interest rate or currency exchange rate fluctuations;

our ability or inability to raise additional capital;

our ability to report accurate financial results in our periodic reports filed with the SEC;

disclosures of previously non-public information in connection with our segment reporting, which commenced in the second fiscal quarter of 2011; and

changes in stock market analyst recommendations regarding our common stock, other comparable companies or our industry generally.

**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 and loss of market share.**

We compete in a rapidly evolving and fiercely competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors in the commercial business market include Allied Telesys, Barracuda, Buffalo, Data Robotics, Dell, D-Link, Fortinet, Hewlett-Packard, Huawei, Cisco Systems, the Linksys division of Cisco Systems, QNAP Systems, Seagate Technology, SonicWALL, Synology, WatchGuard and Western Digital. Our principal competitors in the home market for networking devices and television connectivity products include Apple, Belkin, D-Link, the Linksys division of Cisco Systems, Roku and Western Digital. Our principal competitors in the broadband service provider market include Actiontec, ARRIS, Comtrend, D-Link, Hitron, Huawei, Motorola, Pace, Sagem, Scientific Atlanta—a Cisco company, SMC Networks, TechniColor, Ubee, Compal Broadband, ZTE and ZyXEL. Other current and potential competitors include numerous local vendors such as Devolo, LEA and AVM in Europe, Corega and Melco in Japan and TP-Link in China. Our potential competitors also include other consumer electronics vendors, including LG Electronics, Microsoft, Panasonic, Samsung, 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 are 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.

## Edgar Filing: NETGEAR, INC - Form 10-K

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

---

**Table of Contents**

we can. We anticipate that current and potential competitors will also intensify their efforts to penetrate our target markets. For example, price competition is intense in our industry in certain geographical regions and product categories. Specifically in the service provider space, many of our competitors price their products significantly below our product costs in order to gain market share. 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. These companies could devote more capital resources to develop, manufacture and market competing products than we could. 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.

**Economic conditions are likely to 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 services markets, and changes in the overall demand for networking products. A severe and/or prolonged economic downturn could adversely affect our customers' financial condition and the levels of business activity of our customers. Continued uncertainty about current global economic conditions could 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.

The recent economic problems affecting the banking system and financial markets and the recent uncertainty in global economic conditions has resulted in a number of adverse effects including tightening in the credit markets, 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 recent challenges faced by the European Union to stabilize some of its member economies, such as Greece, Portugal, Spain, Hungary and even Italy, has had international implications affecting the stability of global financial markets and hindering economies worldwide. Should the European Union monetary policy measures be insufficient to restore confidence and stability to the financial markets, the recovery of the global economy, including the U.S. and European Union economies where we have a significant presence, could be hindered or reversed, which could have a material adverse effect on us. There could also be a number of follow-on effects from these economic developments and negative economic trends 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 conditions in the global economy, including Europe and the U.S., or other key vertical or geographic markets remain uncertain or weaken further, such conditions could have a material adverse impact on our business, operating results and financial condition. In addition, 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.

**Our business is subject to the risks of international operations.**

We derive a significant portion of our revenue from international operations. As a result, our financial condition and operating results could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws, changes in the value of the U.S. dollar versus local currencies, and natural disasters. Margins on sales of our products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations. Additionally, certain foreign countries have complex regulatory requirements as conditions of doing business. For example, the United Kingdom Anti-Bribery Act of 2010 is broad legislation that prohibits bribery and applies to our operations

---

## **Table of Contents**

worldwide. This foreign legislation follows in the spirit of the U.S. Foreign Corrupt Practices Act and focuses additional governmental efforts on anticorruption efforts worldwide. Meeting these requirements may increase our operating expenses as we continue to expand internationally.

### **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, control 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.

### **If we fail to continue to introduce new products 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 and introduce new products that achieve broad market acceptance. Our future success will depend in large part upon our ability to identify demand trends in the commercial business, retail, and service provider markets and quickly develop, manufacture and sell products 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. Successfully predicting demand trends is difficult, and it is very difficult to predict the effect 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.

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. Any future delays in product development and introduction or product introductions that do not meet broad market acceptance 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;

## Table of Contents

adverse reactions in our sales channels, such as reduced shelf space, reduced online product visibility, or loss of sales channel; and

increased levels of product returns.

Throughout 2010 and 2011, we have significantly increased the rate of our new product introductions. If we cannot sustain the rapid pace of innovation, we may not be able to maintain or increase the market share of our products. In addition, if we are unable to successfully introduce new products with higher gross margins, our net revenue and overall gross margin would likely decline.

**We obtain several key components from limited or sole sources, and if these sources fail to satisfy our supply requirements, we may lose sales and experience increased component costs.**

Any shortage or delay in the supply of key product components would harm our ability to meet scheduled product deliveries. Many of the semiconductors used in our products are specifically designed for use in our products and are obtained from sole source suppliers on a purchase order basis. In addition, some components that are used in all our products are obtained from limited sources. These components include connector jacks, plastic casings and physical layer transceivers. We also obtain switching fabric semiconductors, which are used in our Ethernet switches and Internet gateway products, and wireless local area network chipsets, which are used in all of our wireless products, from a limited number of suppliers. Semiconductor suppliers have experienced and continue to experience component shortages themselves, such as with substrates used in manufacturing chipsets, which in turn adversely impact our ability to procure semiconductors from them. Our third-party manufacturers generally purchase these components on our behalf on a purchase order basis, and we do not have any contractual commitments or guaranteed supply arrangements with our suppliers. If demand for a specific component increases, we may not be able to obtain an adequate number of that component in a timely manner. In addition, if worldwide demand for the components increases significantly, the availability of these components could be limited. Further, our suppliers may experience financial or other difficulties as a result of uncertain and weak worldwide economic conditions. 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.

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 in the fourth quarter of 2009 limited our ability to supply all the worldwide demand for our products and our revenue was affected.

Another example relates to the recent record flooding in Thailand in the third quarter of 2011. Many major manufacturers of hard disk drives and their component suppliers maintain significant operations in Thailand in areas affected by the flooding. These include most, if not all, of our direct and indirect suppliers of hard disk drives for our ReadyNAS product line. All of our major direct and indirect suppliers of hard disk drives informed us that our supply chain would be constrained for an indefinite amount of time, in some cases up to six months. Some have therefore declared a force majeure event and have stated that, in addition to and because of the supply constraints, pricing for hard disk drives has and will likely continue to increase significantly until they are able to stabilize the situation. We experienced increased prices in the cost of hard disk drives and we believe those increases may continue. As a result, the Company ceased accepting any additional orders containing ReadyNAS products with hard disk drives at then current prices and all shipments of ReadyNAS products with hard disk drives were placed on hold. In addition, all sales and marketing promotions involving ReadyNAS products were and continue to be terminated indefinitely. Further, the Company declared the existence of a force majeure event under our contracts with certain customers. Accordingly, our business was harmed.

---

## **Table of Contents**

In addition, the earthquakes in Northern Japan in March 2011 and the resultant nuclear threats and tsunamis created uncertainty of supply for certain components and raw materials for our products. We have made alternative arrangements and have planned accordingly but there is no guarantee that our ancillary planning will be effective to maintain production of our products.

**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.

**Changes in tax rates, adverse 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 the regulatory environment;

Changes in accounting and tax standards or practices

Changes in the composition of operating income by tax jurisdiction; and

Our operating results before taxes.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective tax rate has fluctuated in the past and may fluctuate in the future. Future effective tax rates could be affected by changes in the composition of earnings in countries with differing tax rates, changes in deferred tax assets and liabilities, or changes in tax laws.

We are also subject to examination by the Internal Revenue Service ( IRS ) and other tax authorities, including state revenue agencies and foreign governments. In 2011, the IRS commenced an examination of the Company's 2008 and 2009 tax years. 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 other tax authorities have increasingly focused attention on intercompany transfer pricing with respect to sales of products and services and the use of intangible assets. Tax authorities could disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. Any such disagreements may affect our profitability.

**We are subject to, and must remain in compliance with, numerous governmental regulations concerning the manufacturing and use of our products, as well as any such future 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 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

---

**Table of Contents**

products, as well as the locations where we sell our products. For example, certain regulations limit the use of lead in electronic components. To the best of our knowledge, we maintain compliance with all 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 future regulations may be 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 Securities and Exchange Commission has proposed new rules in December 2010 regarding investigation and disclosure of the use of certain conflict materials in our products and final rules may be forthcoming in the first half of 2012. If final rules are adopted, we contemplate that the rules may apply to our business and accordingly, we may need to expend additional resources to ensure compliance. While we do not currently know of any other proposed regulation regarding components in our products which would have a material impact on our business, if there is an unanticipated new regulation which significantly impacts our use of various components or requires more expensive components, that would have a material adverse impact on our business, financial condition and results of operations.

One area which has a large number of regulations is the environmental area. Environmental areas such as pollution and climate change have had significant legislative and regulatory efforts on a global basis, and there are expected to be additional changes to the regulations in these areas. 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. Other regulations in the environmental area may require us to continue to monitor and ensure proper disposal or recycling of our products. While future changes in regulations appears likely, 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 affect on our business, financial condition and results of operations.

In addition to government regulations, many of our customers require us to comply with their own requirements regarding manufacturing, health and safety matters, 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. 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 affect on our business, financial condition and results of operations.

**We rely on a limited number of retailers and wholesale distributors for most of our sales, and if they refuse to pay our requested prices or reduce their level of purchases, our net revenue could decline.**

We sell a substantial portion of our products through retailers, including Best Buy Co., Inc. and its affiliates, and wholesale distributors, including Ingram Micro, Inc. and Tech Data Corporation. We expect that a significant portion of our net revenue will continue to come from sales to a small number of retailers and wholesale distributors for the foreseeable future. In addition, because our accounts receivable are 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 retailers and wholesale distributors fails or becomes insolvent. We generally have no minimum purchase commitments or long-term contracts with any of these retailers or distributors. These purchasers could decide at any time to discontinue, decrease or delay their purchases of our products. 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



---

## **Table of Contents**

our principal customers is essential to our future performance. If any of our major retailers or wholesale distributors 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. If our retailers or wholesale distributors 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.

Additionally, if there is consolidation among our customer base, certain customers may be able to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, 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, replacement of our products with those of our competitors and cancellations of orders, each of which would harm our operating results.

### **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. During the year ended December 31, 2011, sales to Best Buy and its affiliates accounted for approximately 11% of our net revenue and sales to Ingram Micro and its affiliates accounted for approximately 10% of our net revenue. During the year ended December 31, 2010, sales to Best Buy and its affiliates accounted for approximately 15% of our net revenue and sales to Ingram Micro and its affiliates accounted for approximately 11% of our net revenue. While these customers each accounted for approximately 10% or greater than 10% of our net revenue during the year ended December 31, 2011, there is no assurance that either of them will continue to purchase our products at the same rate for any future periods.

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, such as the one-time approximately \$10 million dollar order from a service provider customer in the second fiscal quarter of 2011. 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 disrupt our business. Although our largest customers may vary from period to period, we anticipate that our operating results for any given period will continue to depend on large orders from a small number of customers.

### **We 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

---

## Table of Contents

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, such as Cisco Systems, 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. 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. We also sell products to broadband service providers. Competition for selling to broadband service providers is 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 were unable to maintain and expand our sales channels, our growth would be limited and our business would be harmed.

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

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

All of our products are manufactured, assembled, tested and generally packaged by a limited number of original design manufacturers ( ODMs ) and original equipment manufacturers ( OEMs ). We rely on our 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. Due to weak economic conditions, the viability of some of these third-party manufacturers may be at risk. Our ODM s are increasingly refusing to work with us on certain projects, such as projects for manufacturing products for our service provider customers. Because our service providers command significant resources, including for software support, and demand extremely competitive pricing, our ODM s are starting to refuse to engage on service provider terms. The loss of the services of any of our primary third-party manufacturers could cause a significant disruption in operations and delays in product shipments. Qualifying a new manufacturer and commencing volume production is expensive and time consuming. As we contemplate moving manufacturing into different jurisdictions, we will be 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 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.



## **Table of Contents**

All of our products must satisfy safety and regulatory standards and some of our products must also receive government certifications. Our ODMs and OEMs are primarily responsible for obtaining most regulatory approvals for our products. If our ODMs and OEMs fail to obtain timely domestic or foreign regulatory approvals or certificates, 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 occurs in mainland China and any disruptions from natural disasters, health epidemics and political, social and economic instability would affect the ability of our ODMs to manufacture our products. In addition, our ODMs in China have continued to increase our costs of production, particularly in 2010 and 2011. These increased costs have affected our margins and ability to lower prices for our products to stay competitive. Recent labor unrest in China may also affect our ODMs as workers may strike and cause production delays. If our ODMs and OEMs 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 our products and our business would be significantly harmed.

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

Our future success depends in large part upon the continued services of our key technical, 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. The loss of any of our senior management or other key 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 the commercial business, consumer, and service provider markets. 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. 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 Patrick Lo or other key personnel retire, resign or are otherwise terminated.

**We are currently involved in numerous litigation matters and may in the future become involved in additional litigation, including litigation regarding intellectual property rights, 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

## Table of Contents

significant as well. At any time, any of these non-practicing entities, or any other third-party could initiate litigation against us, or we may be forced to initiate litigation against them, which could divert management attention, be costly to defend or prosecute, prevent us from using or selling the challenged technology, require us to design around the challenged technology and cause the price of our stock to decline. In addition, third parties, some of whom are potential competitors, have initiated and may continue to initiate litigation against our manufacturers, suppliers, members of our sales channels or our service provider customers, 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. Finally, 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. For additional information regarding certain of the lawsuits in which we are involved, see the information set forth under Note 9, *Commitments and Contingencies*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

### **We will be investing increased additional in-house resources on software research and development, which could disrupt our ongoing business and present risks not originally contemplated.**

We plan to continue to evolve our historically hardware-centric business model towards a model that includes more software offerings. As such, we will further evolve the focus of our organization towards the delivery of more integrated hardware and software solutions for our customers. While we have invested in software development in the past, we will be expending additional resources in this area in the future. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset liabilities assumed and expenses associated with the strategy, inadequate return on capital, and unidentified issues not discovered in our due diligence. 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. This initiative for increased investment in software research and development may materially adversely affect the Company's financial condition and operating results.

We may spend a proportionately greater amount on software research and development in the future. If the Company 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, pricing and other factors are not sufficiently competitive, or if there is an adverse reaction to our product decisions, we may lose market share in certain areas, which could adversely affect our revenue and prospects.

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

---

**Table of Contents**

**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 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.

During the second quarter of fiscal 2009, in connection with the restatement of our previously issued financial statements for the period ended March 29, 2009, and our assessment of our disclosure controls and procedures, management concluded that as of March 29, 2009, our disclosure controls and procedures were not effective and that we had a material weakness in internal control over financial reporting. The material weakness related to the accounting for income taxes. Specifically, we did not maintain a sufficient complement of tax personnel with the required proficiency to identify, evaluate, review, and report complex tax accounting matters. In order to remediate the material weakness, we hired additional personnel in the tax department with sufficient knowledge and experience in tax to strengthen the controls around the tax provision. We also engaged tax specialists to assist us in the preparation and review of the income tax provision. As a result of these actions, management has concluded that we have remediated the material weakness related to income taxes as of December 31, 2009.

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.

**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. For example, in January 2008, we announced a voluntary recall of the XE103 Powerline Ethernet Adapter made for Europe and other countries using 220-240 volt power sources and sold individually or in a bundled kit.

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, our reputation and brand could be damaged, and we could face legal claims regarding our products. A product liability or other claim could result in negative publicity and harm to our reputation, resulting in unexpected

---

## **Table of Contents**

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.

### **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.

The transportation network is subject to disruption or congestion from a variety of causes, including labor disputes or port strikes, acts of war or terrorism, natural disasters and congestion resulting from higher shipping volumes. Labor disputes among freight carriers and at ports of entry are common, particularly in Europe, and we expect labor unrest and its effects on shipping our products to be a continuing challenge for us. 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, including in the fourth quarter of 2009, we have shipped products using extensive air freight to meet unexpected spikes in demand, shifts in demand between product categories and to bring new product introductions to market quickly. If we rely more heavily upon air freight to deliver our products, our overall shipping costs will increase. A prolonged transportation disruption or a significant increase in the cost of freight could severely disrupt our business and harm our operating results.

### **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. Although any resulting loss has not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. To the degree that the recent 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 we fail to successfully overcome the challenges associated with profitably growing our broadband service provider sales channel, our net revenue and gross profit will be negatively impacted.**

We sell a substantial portion of our products through broadband service providers worldwide. Our service provider business unit accounted for a significant portion of our growth in 2011. We face a number of challenges associated with penetrating, marketing and selling to the broadband service provider channel that differ from what we have traditionally faced with the other channels. 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

---

**Table of Contents**

contractual business terms, competition from established suppliers, pricing pressure resulting in lower gross margins, and irregular and unpredictable ordering habits. For example, 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. In addition, because our service providers command significant resources, including for software support, and demand extremely competitive pricing, our ODM s are starting to refuse to engage on service provider terms. Accordingly, as our ODM s increasingly decline to take orders for manufacturing our service provider products, our service provider business will be harmed.

Further, as the deployment of DOCSIS 3.0 technology by broadband service providers increases worldwide during 2011 and 2012, we anticipate competing in an extremely price sensitive market and our margins may be affected. 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. 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. For example, we have been at the forefront of developing and selling DOCSIS 3.0 products to our service provider customers in 2010 and 2011. As our competitors develop DOCSIS 3.0 products, our service provider customers may use these competitor products as an alternate source for this technology. Our service provider customers may then require us to lower our prices or they may choose to purchase more DOCSIS 3.0 products from our competitors. Accordingly, our business may be harmed and our revenues may 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. Many of the service provider customers will seek to purchase from the lowest cost provider, notwithstanding that our products may be higher quality or 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 grow our service provider sales channel and our growth will be slowed.

**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, we closed our acquisition of the Customer Networking



## Table of Contents

Solutions division of Westell Technologies, Inc. in April 2011. 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;

growing or maintaining revenues to justify the purchase price and the increased expenses associated with acquisitions;

entering into territories or markets that we have limited or no prior experience with;

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;

diverting management's attention from running the day to day operations of our business; 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.

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 in every instance.**

We have made, and continue to seek to make, investments in companies around the world to further our strategic objectives and support our key business initiatives. These investments may include equity or debt instruments of public or private companies, and may be non-marketable at the time of our initial investment. We do not restrict the types of companies in which we seek to invest. These companies may range from early-stage companies that are often still defining their strategic direction to more mature companies with established revenue streams and business models. If any company in which we invest fails, we could lose all or part of our investment in that company. If we determine that an other-than-temporary decline in the fair value exists for an equity or debt investment in a public or private company in which we have invested, we will have to write down the investment to its fair value and recognize the related write-down as an investment loss. The performance of any of these investments could result in significant impairment charges and gains (losses) on other equity investments. 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.

## Edgar Filing: NETGEAR, INC - Form 10-K

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

---

**Table of Contents**

equity investments in private companies are not liquid, and we may not be able to dispose of these investments on favorable terms or at all. The occurrence of any of these events could harm our results. Gains or losses from equity securities could vary from expectations depending on gains or losses realized on the sale or exchange of securities and impairment charges related to debt instruments as well as equity and other investments.

**We are 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 implemented a hedging program in November 2008 to hedge exposures to fluctuations in foreign currency exchange rates as a response to the risks 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, in the second fiscal quarter of 2009, we commenced implementation of a hedging program to reduce the impact of volatile exchange rates on net revenues, gross profit and operating profit for limited periods of time. However, the use of such hedging activities may only offset a portion of the adverse financial effect resulting from unfavorable movements in foreign exchange rates.

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

Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered when determining if the carrying value of our goodwill or amortizable 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 amortizable intangible assets recorded on our balance sheet. In addition, significant negative industry or economic trends, such as those that have occurred as a result of the recent economic downturn, including reduced estimates of future cash flows or disruptions to our business could indicate that goodwill or amortizable 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. We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from actual results. As a result, we may incur substantial impairment charges to earnings in our financial statements should an impairment of our goodwill or amortizable intangible assets be determined resulting in an adverse impact on our results of operations.

---

## **Table of Contents**

In the second fiscal quarter of 2011, in connection with our reorganization into three specific business units (retail, commercial, and service provider), we allocated goodwill to each business unit and evaluated those allocations for potential impairment. No impairment existed as of the end of the second fiscal quarter of 2011. In the fourth fiscal quarter of 2011, we completed our annual impairment test of goodwill and determined no impairment existed as of December 31, 2011. We will continue to test goodwill for impairment at least annually at the business unit level. The allocation of goodwill may have greater impact for certain of the business segments, as compared to the other segments. Accordingly, the performance of a business unit may be adversely affected by the allocation of goodwill.

### **If we are unable to provide our third-party manufacturers a timely and accurate forecast of our component and material requirements, we may experience delays in the manufacturing of our products and the costs of our products may increase.**

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

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

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

We also utilize third-party software development companies to develop, customize, maintain and support software that is incorporated into our products. If these companies fail to timely deliver or continuously maintain and support the software, as we require of them, we may experience delays in releasing new products or difficulties with supporting existing products and customers. In addition, if these third-party licensors fail, then

---

## **Table of Contents**

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 understand and use the source code, as we may not have the expertise to do so. We are increasingly exposed to these risks as we continue to develop and market more products containing third-party software, such as our TV connectivity, security and network attached storage products.

### **If the redemption rate for our end-user promotional programs is higher than we estimate, then our net revenue and gross margin will be negatively affected.**

From time to time we offer promotional incentives, including cash rebates, to encourage end-users to purchase certain of our products. Purchasers must follow specific and stringent guidelines to redeem these incentives or rebates. Often qualified purchasers choose not to apply for the incentives or fail to follow the required redemption guidelines, resulting in an incentive redemption rate of less than 100%. Based on historical data, we estimate an incentive redemption rate for our promotional programs. If the actual redemption rate is higher than our estimated rate, then our net revenue and gross margin will be negatively affected.

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

We rely upon third parties for a substantial portion of the intellectual property that we use in our products. At the same time, we rely on a combination of copyright, trademark, patent and trade secret laws, nondisclosure agreements with employees, consultants and suppliers and other contractual provisions to establish, maintain and protect our intellectual property rights. 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. Our inability to secure and protect our intellectual property rights could significantly harm our brand and business, operating results and financial condition.

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

International sales comprise a significant amount of our overall net revenue. International sales were 52% of overall net revenue in fiscal 2011 and 50% of overall net revenue in fiscal 2010. 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:

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;

exchange rate fluctuations;

increased difficulty in managing inventory;

delayed revenue recognition;

less effective protection of intellectual property;

---

**Table of Contents**

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 recently enacted Ecodesign directive (EuP) in Europe, that may vary from country to country and that are costly to comply with;

difficulties and costs of staffing and managing foreign operations;

business difficulties, including potential bankruptcy or liquidation, of any of our worldwide third party logistics providers; and

changes in local tax laws.

We are 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, such as the European Ecodesign directive (EuP), they may cease to order our products and our revenue would be harmed.

**We are expanding and reorganizing our operations and infrastructure, which may strain our operations and increase our operating expenses.**

We are expanding and reorganizing our operations and pursuing market opportunities both domestically and internationally in order to grow our sales. We expect that this attempted expansion will require enhancements to our existing management information systems, and operational and financial controls. In addition, if we continue to grow, our expenditures will 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. In the second fiscal quarter of 2011, we reorganized our business into three business units: retail, commercial, and service provider. The Company's reorganization into three business units may cause significant distraction to our management and employees. For example, channel and pricing conflicts may arise in certain territories as each of our business units may engage in selling activities which may benefit that business unit at the expense of another business unit. In addition, disclosures of previously non-public information in connection with our reorganization may also provide our competitors with strategic data which may put us at a competitive disadvantage and harm our business. These new disclosures about our performance may also cause our stock price to decline. If we fail to continue to improve our management information systems, procedures and financial controls or encounter unexpected difficulties during expansion and reorganization, our business could be harmed.

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

**We have had to restate our historical financial statements.**

In July 2009, we announced that we had incorrectly reported our income tax provision for the three months ended March 29, 2009 and, as a result of this error, we restated the financial statements in our quarterly report on Form 10-Q for the three months ended March 29, 2009. The restatement, which related solely to the correction of

---

**Table of Contents**

the income tax provision for the three months ended March 29, 2009, resulted in adjustments related to income taxes in our financial statements. In our previously filed financial statements for the three months ended March 29, 2009, we incorrectly included a particular foreign entity in calculating our estimated annualized tax provision. This foreign entity should not have been included in the calculation because the anticipated losses in that entity would not give rise to tax benefits. While our overall annual tax provision was not affected for the entire year, we made an error in inter-quarter allocations of the tax provision. Material changes to our previously reported financial information occurred as a result of this error.

In connection with this restatement we identified certain control deficiencies relating to the application of applicable accounting literature related to recordation of tax expenses. These deficiencies constituted a material weakness in internal control over financial reporting as of March 29, 2009, which led to items requiring correction in our financial statements and our conclusion to restate such financial statements to correct those items. Specifically, the control deficiencies related to our failure to correctly apply the authoritative guidance for income taxes in determining the proper allocation of our annualized tax provision.

Although this material weakness had been remediated by December 31, 2009, we cannot be certain that the measures we have taken since this restatement will ensure that restatements will not occur in the future. Execution of restatements like the one described above 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.

**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.

**Economic conditions, political events, war, terrorism, public health issues, natural disasters 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. Significantly all of our critical enterprise-wide information technology systems, including our main servers, are currently housed in colocation



---

**Table of Contents**

facilities near our headquarters in Northern California. While we have moved our critical information technology systems in 2010 to 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, substantially all of our manufacturing occurs in two geographically concentrated areas in 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.

We depend significantly on worldwide economic conditions and their impact on consumer spending levels, which have recently deteriorated significantly in many countries and regions, including without limitation the United States, and may remain depressed for the foreseeable future. Factors that could influence the levels of consumer spending include increases in fuel and other energy costs, conditions in the residential real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence and other macroeconomic factors affecting consumer spending behavior.

In addition, war, terrorism, geopolitical uncertainties, public health issues, 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. For example, labor disputes at manufacturing facilities in China occurred in 2010 and have led to workers going on strike. The recent trend of labor unrest could materially affect our third-party manufacturers' abilities to manufacture our products. In addition, all of our major direct and indirect suppliers of hard disk drives have been affected by record flooding in Thailand in the third fiscal quarter of 2011, and they informed us that our supply chain would be constrained for an indefinite amount of time, up to six months in some cases. Some have therefore declared a force majeure event and have stated that, in addition to and because of the supply constraints, pricing for hard disk drives has and will likely continue to increase significantly until they are able to stabilize the situation. We experienced increased prices in the cost of hard disk drives and those increases may continue. As a result, the Company ceased accepting any orders containing ReadyNAS products with hard disk drives. In addition, all then current sales and marketing promotions involving ReadyNAS products were terminated indefinitely. Further, the Company declared the existence of a force majeure event under our contracts with certain customers. Accordingly, our business was harmed. Furthermore, earthquakes and resultant nuclear threats and tsunamis in Japan in March 2011 have caused some disruption to our supply of raw materials and components for our products and may impact our operating results in Japan.

Such events could decrease demand for our products, make it difficult or impossible for us to make and deliver products to our customers or to receive components from our suppliers, and create delays and inefficiencies in our supply chain. Should major public health issues, including pandemics, arise, we could be negatively affected by 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.

**System security risks, data protection breaches and cyber-attacks could disrupt our internal operations or information technology or networking services provided to customers, and any such disruption could reduce our expected revenue, increase our expenses, damage our reputation and adversely affect our stock price.**

Maintaining the security of our computer information systems and communication systems is a critical issue for us and our customers. Hackers may develop and deploy viruses, worms and other malicious software programs that are designed to attack 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 or users of our products to disclose sensitive information in order to gain access to our data or our customers' data. We have not established a formal business continuity plan. While we have established infrastructure and geographic redundancy for our

---

**Table of Contents**

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. If our computer systems and servers go down at the end of a fiscal quarter, our ability to recognize revenue may be delayed until we were able to utilize back-up systems and continue to process and ship our orders. This could cause our stock price to decline significantly. Moreover, 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 or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery 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, damage our brand and reputation or otherwise harm our business.

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

Our principal administrative, sales, marketing and research and development facilities currently occupy approximately 142,700 square feet in an office complex in San Jose, California, under a lease that expires in March 2018.

Our international headquarters occupy approximately 10,000 square feet in an office complex in Cork, Ireland, under a lease entered into in February 2006 and expiring in December 2026. Our international sales personnel are based out of local sales offices or home offices in Austria, Australia, Brazil, Canada, China, Czech Republic, Denmark, France, Germany, Hong Kong, India, Italy, Japan, Korea, Mexico, New Zealand, Poland, Russia, Singapore, Spain, Sweden, Switzerland, the Netherlands, the United Arab Emirates, and the United Kingdom. We also have operations personnel using a leased facility in Hong Kong. We also maintain research and development facilities in Atlanta, Chicago, Beijing, Guangzhou, Nanjing, and Shanghai, China, and in Taipei, Taiwan. From time to time we consider various alternatives related to our long-term facilities needs. While we believe our existing facilities provide suitable space for our operations and are adequate to meet our immediate needs, it may be necessary to lease additional space to accommodate future growth. We have invested in internal capacity and strategic relationships with outside manufacturing vendors as needed to meet anticipated demand for our products.

We use third parties to provide warehousing services to us, consisting of facilities in Southern California, Australia, Hong Kong and the Netherlands.

**Item 3. *Legal Proceedings***

The information set forth under the heading "Litigation and Other Legal Matters" in Note 9, *Commitments and Contingencies*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, is incorporated herein by reference. For additional discussion of certain risks associated with legal proceedings, see Item 1A, *Risk Factors*.

**Item 4. *Mine Safety Disclosures***

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information**

Our common stock has been quoted under the symbol NTGR on the Nasdaq National Market from July 31, 2003 to July 1, 2006, and on the Nasdaq Global Select Market since then. Prior to that time, there was no public market for our common stock. The following table sets forth for the indicated periods the high and low intraday sales prices for our common stock on the Nasdaq markets. Such information reflects interdealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

<b>Fiscal Year Ended December 31, 2010</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 27.39	\$ 20.29
Second Quarter	28.96	18.63
Third Quarter	28.18	17.44
Fourth Quarter	35.50	25.80

<b>Fiscal Year Ended December 31, 2011</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 38.00	\$ 29.97
Second Quarter	44.60	30.31
Third Quarter	45.31	24.87
Fourth Quarter	38.47	23.45

**Equity Compensation Plan Information**

The following table provides information as of December 31, 2011 about our common stock that may be issued upon the exercise of options and rights granted to employees or members of our Board of Directors under all existing equity compensation plans, including the 2000 Plan (which was terminated as to new grants in May 2003), the 2003 Stock Plan, the 2006 Long Term Incentive Plan and the 2003 Employee Stock Purchase Plan.

<b>Plan Category</b>	<b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
Equity compensation plans approved by security holders	4,126,562(1)	\$ 25.87	1,192,463(2)
Equity compensation plans not approved by security holders		\$	
<b>Total</b>	<b>4,126,562</b>		<b>1,192,463</b>

(1) Includes 259,230 shares subject to options outstanding under the 2003 Plan, 3,867,332 shares subject to options outstanding under the 2006 Plan and no outstanding shares under the 2003 Employee Stock Purchase Plan.

(2)

## Edgar Filing: NETGEAR, INC - Form 10-K

Includes 255,445 shares available for future issuance under the 2003 Plan, 486,349 shares available for future issuance under the 2006 Plan and 450,669 shares available for future issuance under the 2003 Employee Stock Purchase Plan.

**Table of Contents****Company Performance**

*Notwithstanding any statement to the contrary in any of our previous or future filings with the SEC, the following information relating to the price performance of our common stock shall not be deemed filed with the SEC or soliciting material under the Exchange Act and shall not be incorporated by reference into any such filings.*

The following graph shows a comparison from December 31, 2006 through December 31, 2011 of cumulative total return for our common stock, the Nasdaq Composite Index and the Nasdaq Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Nasdaq Computer Index assume reinvestment of dividends. We have never paid dividends on our common stock and have no present plans to do so.

	December 31, 2006	December 31, 2007	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011
NETGEAR, Inc.	\$ 100.00	\$ 135.89	\$ 43.47	\$ 82.63	\$ 128.30	\$ 127.89
NASDAQ Computer Index	\$ 100.00	\$ 121.86	\$ 64.96	\$ 110.97	\$ 130.32	\$ 130.96
NASDAQ Composite Index	\$ 100.00	\$ 109.81	\$ 65.29	\$ 93.95	\$ 109.84	\$ 107.86

**Holders of Common Stock**

On February 21, 2012, there were 28 stockholders of record.

The number of record holders is based upon the actual number of holders registered on our books at such date and does not include holders of shares in street names or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

**Dividend Policy**

We have never declared or paid cash dividends on our capital stock. We currently intend to retain future earnings, if any, to finance the operation and expansion of our business, and we do not anticipate paying cash dividends in the foreseeable future.

**Table of Contents****Repurchase of Equity Securities by the Company**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</b>
October 3, 2011-November 2, 2011	917	\$ 29.76		4,831,220
November 3, 2011-December 2, 2011				4,831,220
December 3, 2011-December 31, 2011				4,831,220
	917	\$ 29.76		

On October 21, 2008, our Board of Directors authorized management to repurchase up to 6,000,000 shares of our outstanding common stock. Under this authorization, 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 our share price. During the years ended December 31, 2011, 2010 and 2009, we did not repurchase any shares of common stock under this repurchase authorization. However, we repurchased approximately 25,000 shares or \$926,000 of common stock related to the lapse of RSUs during the year ended December 31, 2011.

**Item 6. Selected Consolidated Financial Data**

The following selected consolidated financial data are qualified in their entirety, and should be read in conjunction with, the consolidated financial statements and related notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K.

We derived the selected consolidated statement of operations data for the years ended December 31, 2011, 2010 and 2009 and the selected consolidated balance sheet data as of December 31, 2011 and 2010 from our audited consolidated financial statements appearing elsewhere in this Form 10-K. We derived the selected consolidated statement of operations data for the years ended December 31, 2008 and 2007 and the selected consolidated balance sheet data as of December 31, 2009, 2008 and 2007 from our audited consolidated financial statements, which are not included in this Form 10-K. Historical results are not necessarily indicative of results to be expected for future periods.

**Table of Contents**

	2011	Year Ended December 31,			2007
		2010	2009	2008	
		(In thousands, except per share data)			
<b>Consolidated Statement of Operations Data:</b>					
Net revenue	\$ 1,181,018	\$ 902,052	\$ 686,595	\$ 743,344	\$ 727,787
Cost of revenue(2)	811,572	602,805	480,195	502,320	485,180
Gross profit	369,446	299,247	206,400	241,024	242,607
<b>Operating expenses:</b>					
Research and development(2)	48,699	39,972	30,056	33,773	28,070
Sales and marketing(2)	154,562	131,570	106,162	121,687	117,938
General and administrative(2)	39,423	36,220	32,727	31,733	27,220
Restructuring and other charges	2,094	(88)	809	1,929	
In-process research and development				1,800	4,100
Technology license arrangements			2,500		
Litigation reserves, net	(201)	211	2,080	711	167
Total operating expenses	244,577	207,885	174,334	191,633	177,495
Income from operations	124,869	91,362	32,066	49,391	65,112
Interest income, net	477	426	629	4,336	8,426
Other income (expense), net	(1,136)	(564)	(128)	(8,384)	3,298
Income before income taxes	124,210	91,224	32,567	45,343	76,836
Provision for income taxes	32,842	40,315	23,234	27,293	30,882
Net income	\$ 91,368	\$ 50,909	\$ 9,333	\$ 18,050	\$ 45,954
<b>Net income per share:</b>					
Basic(1)	\$ 2.46	\$ 1.44	\$ 0.27	\$ 0.51	\$ 1.32
Diluted(1)	\$ 2.41	\$ 1.41	\$ 0.27	\$ 0.51	\$ 1.28

- (1) Information regarding calculation of per share data is described in Note 6, *Net Income Per Share*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.
- (2) Stock-based compensation expense was allocated as follows:

Cost of revenue	\$ 999	\$ 913	\$ 959	\$ 864	\$ 633
Research and development	2,476	2,271	1,973	3,218	2,391
Sales and marketing	5,136	4,710	4,147	3,406	3,013
General and administrative	5,151	4,307	3,945	3,835	2,842

	2011	2010	December 31, 2009	2008	2007
	(In thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents and short-term investments	\$ 353,695	\$ 270,737	\$ 247,100	\$ 203,009	\$ 205,343
Working capital	\$ 525,268	\$ 413,321	\$ 339,116	\$ 312,843	\$ 311,082

Edgar Filing: NETGEAR, INC - Form 10-K

Total assets	\$ 971,370	\$ 780,321	\$ 633,121	\$ 586,209	\$ 551,109
Total current liabilities	\$ 308,961	\$ 254,723	\$ 195,609	\$ 176,505	\$ 168,507
Total non-current liabilities	\$ 23,652	\$ 25,162	\$ 23,359	\$ 18,746	\$ 11,079
Total stockholders' equity	\$ 638,757	\$ 500,436	\$ 414,153	\$ 390,958	\$ 371,523



---

## **Table of Contents**

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

*You should read the following discussion of our financial condition and results of operations together with the audited consolidated financial statements and notes to the financial statements included elsewhere in this Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry, business and future financial results. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those discussed under Risk Factors in Part I, Item 1A above.*

### **Business Overview**

We are a global networking company that delivers innovative products to consumers, businesses and service providers. For consumers, we make high performance, dependable and easy-to-use home networking, storage and digital media products to connect people with the Internet and their content and devices. For businesses, we provide networking, storage and security solutions without the cost and complexity of Big IT. We also supply leading service providers with retail, whole home networking solutions for their customers. Our products are built on a variety of proven technologies such as wireless, Ethernet and powerline, with a focus on reliability and ease-of-use.

Our product line consists of wired and wireless devices that enable networking, broadband access, network connectivity, network storage and security appliances. These products are available in multiple configurations to address the needs of our end-users in each geographic region in which our products are sold.

We sell our networking products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers ( DMRs ), value-added resellers ( VARs ), and broadband service providers. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Fry's Electronics, Radio Shack, Staples, Wal-Mart, Argos (U.K.), Dixons (U.K.), PC World (U.K.), MediaMarkt (Germany, Austria), Dick Smith (Australia), JB HiFi (Australia) and Elkjop (Norway). Online retailers include Amazon.com, Dell, Newegg.com and Buy.com. Our DMRs include CDW Corporation, Insight Corporation and PC Connection in domestic markets and Misco throughout Europe. In addition, we also sell our products through broadband service providers, such as multiple system operators ( MSOs ), DSL, 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 to date has been derived from a limited number of wholesale distributors and retailers, including Ingram Micro and Best Buy. We expect that these wholesale distributors and retailers will continue to contribute a significant percentage of our net revenue for the foreseeable future. Our service provider business has grown substantially and it is difficult to ascertain a seasonal pattern given that the business is less predictable than our other core businesses.

In the second fiscal quarter of 2011, we made organizational changes that resulted in changes to the way in which the CODM manages and evaluates the business. Our business is now managed in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home networking, storage and digital media products to connect people with the Internet and their content and devices. The commercial business unit consists of business networking, storage and security solutions without the cost and complexity of Big IT. The service provider business unit consists of made-to-order and retail proven, whole home networking solutions sold to service provider for sale to their customers. Each business unit is managed by a Senior Vice President/General Manager. There is no change in the CODM before and after the reorganization of the segments. We believe this new structure enables us to better focus our efforts on our core customer segments and allows us to be more nimble and opportunistic as a company overall. Additionally, in the first fiscal quarter of 2011, we combined our North American, Central American and South American sales forces to form the Americas territory. Previously, North America was its own geographic region and the Central American and South American territories were categorized within the Asia Pacific ( APAC ) geographic region. Following this change, we are now organized into the following three geographic territories: Americas, Europe, Middle-East

---

## **Table of Contents**

and Africa ( EMEA ) and APAC. For further detail, refer to Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Item 8 Part II of this Annual Report on Form 10-K.

Our net revenue increased 30.9% during the year ended December 31, 2011. The increase in net revenue was principally attributable to higher sales in several of our product categories in the Americas, Europe, Middle-East and Africa ( EMEA ) and Asia Pacific ( APAC ). These include wireless-N products sold to retailers and existing service provider customers, Powerline products, ReadyNAS products, and switch products.

Our gross margin decreased to 31.3% for the year ended December 31, 2011 from 33.2% for the year ended December 31, 2010. The decrease in gross margin was primarily attributable to a higher percentage of our total revenue derived from sales to service providers, which generally carry lower gross margins. Operating expenses for the year ended December 31, 2011 were \$244.6 million, or 20.7% of net revenue, compared to \$207.9 million, or 23.1% of net revenue, for the year ended December 31, 2010. This increase was primarily attributable to increases of \$24.0 million in salary and other employee related expenses due to headcount growth, and \$6.1 million in outside service costs related to increased investments in research and development projects and increased call center costs driven by greater sales volume. In addition, the increase was also attributable to a \$2.2 million increase in restructuring and other charges primarily due to employee severance resulting from the reorganization into three specific business units.

Net income increased \$40.5 million, or 79.5%, to \$91.4 million for the year ended December 31, 2011, from \$50.9 million for the year ended December 31, 2010. This increase was primarily attributable to an increase in gross profit of \$70.2 million and a decrease in the provision for income tax of \$7.5 million, which was partially offset by an increase in operating expenses of \$36.7 million.

The commercial business, consumer, and broadband service provider markets are intensely competitive and subject to rapid technological change. We expect our competition to continue to intensify. We believe that the principal competitive factors in these markets for networking products include product breadth, 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, and customer service and support. To remain competitive, we believe we must continue to aggressively invest resources in developing new products and enhancing our current products while continuing to expand our channels and maintaining customer satisfaction worldwide.

## **Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the SEC. The preparation of these financial statements requires management to make assumptions, judgments and estimates that can have a significant impact on the reported amounts of assets, liabilities, revenues and expenses. We base our estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. Actual results could differ significantly from these estimates. These estimates may change as new events occur, as additional information is obtained and as our operating environment changes. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We also discuss our critical accounting estimates with the Audit Committee of the Board of Directors. Note 1, *The Company and Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements describes the significant accounting policies used in the preparation of the consolidated financial statements. We have listed below our critical accounting policies that we believe to have the greatest potential impact on our consolidated financial statements. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

---

## **Table of Contents**

### ***Revenue Recognition***

Refer to Note 1, *The Company and Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements of this Annual Report on Form 10-K for a discussion of our revenue recognition policies. Revenue from product sales is generally recognized at the time the product is shipped, provided that persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable and collection of the related receivable is reasonably assured. Currently, for some of our customers, title passes to the customer upon delivery to the port or country of destination, upon their receipt of the product, or upon the customer's resale of the product. At the end of each fiscal quarter, we estimate and defer revenue related to product where title has not transferred. The revenue continues to be deferred until such time that title passes to the customer. We have not made any material changes in the accounting methodology we use to estimate deferred revenue related to product where title has not transferred. We do not believe there will be a material change in the future estimates or assumptions used in our estimate of deferred revenue. We assess collectability based on a number of factors, including general economic and market conditions, past transaction history with the customer, and the creditworthiness of the customer. If we determine that collection of the corresponding receivable is not reasonably assured, we defer the revenue until receipt of payment.

### ***Allowances for Product Warranties, Returns due to Stock Rotation, Sales Incentives and Doubtful Accounts***

Our standard warranty obligation to our direct customers generally provides for a right of return of any product for a full refund in the event that such product is not merchantable or is found to be damaged or defective. At the time revenue is recognized, an estimate of future warranty returns is recorded to reduce revenue in the amount of the expected credit or refund to be provided to our direct customers. At the time we record the reduction to revenue related to warranty returns, we include within cost of revenue a write-down to reduce the carrying value of such products to net realizable value. Our standard warranty obligation to end-users provides for replacement of a defective product for one or more years. Factors that affect the warranty obligation include product failure rates, material usage, and service delivery costs incurred in correcting product failures. The estimated cost associated with fulfilling the warranty obligation to end-users is recorded in cost of revenue. Because our products are manufactured by third-party manufacturers, in certain cases we have recourse to the third-party manufacturer for replacement or credit for the defective products. We give consideration to amounts recoverable from our third-party manufacturers in determining our warranty liability. Our estimated allowances for product warranties can vary from actual results and we may have to record additional revenue reductions or charges to cost of revenue, which could materially impact our financial position and results of operations.

In addition to warranty-related returns, certain distributors and retailers generally have the right to return product for stock rotation purposes. Upon shipment of the product, we reduce revenue for an estimate of potential future stock rotation returns related to the current period product revenue. We analyze historical returns, channel inventory levels, current economic trends and changes in customer demand for our products when evaluating the adequacy of the allowance for sales returns, namely stock rotation returns. Our estimated allowances for returns due to stock rotation can vary from actual results and we may have to record additional revenue reductions, which could materially impact our financial position and results of operations.

We accrue for sales incentives as a marketing expense if we receive an identifiable benefit in exchange and can reasonably estimate the fair value of the identifiable benefit received; otherwise, it is recorded as a reduction of revenues. Our estimated provisions for sales incentives can vary from actual results and we may have to record additional expenses or additional revenue reductions dependent on the classification of the sales incentive.

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We regularly perform credit evaluations of our customers' financial condition and consider factors such as historical experience, credit quality, age of the accounts receivable balances, and geographic or country-specific risks and economic conditions that may affect a customer's ability to pay. The allowance for doubtful accounts is reviewed quarterly and adjusted if necessary based on our

---

## **Table of Contents**

assessments of our customers' ability to pay. If the financial condition of our customers should deteriorate or if actual defaults are higher than our historical experience, additional allowances may be required, which could have an adverse impact on operating expenses.

### ***Valuation of Inventory***

We value our inventory at the lower of cost or market, cost being determined using the first-in, first-out method. We continually assess the value of our inventory and will periodically write down its value for estimated excess and obsolete inventory based upon assumptions about future demand and market conditions. On a quarterly basis, we review inventory quantities on hand and on order under non-cancelable purchase commitments, including consignment inventory, in comparison to our estimated forecast of product demand for the next nine months to determine what inventory, if any, are not saleable. Our analysis is based on the demand forecast but takes into account market conditions, product development plans, product life expectancy and other factors. Based on this analysis, we write down the affected inventory value for estimated excess and obsolescence charges. At the point of loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. As demonstrated during prior years, demand for our products can fluctuate significantly. If actual demand is lower than our forecasted demand and we fail to reduce our manufacturing accordingly, we could be required to write down additional inventory, which would have a negative effect on our gross profit.

### ***Goodwill and Intangibles***

We apply the authoritative guidance for intangibles and perform an annual goodwill impairment test. Should certain events or indicators of impairment occur between annual impairment tests, we will perform the impairment test as those events or indicators occur.

Refer to Note 1, *The Company and Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements of this Annual Report on Form 10-K for a complete discussion of our goodwill policies. In September 2011, the FASB issued ASU 2011-08,

Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment. ASU 2011-08 permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount as a basis for determining if performing the two-step goodwill impairment test is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011; however, early adoption is permitted. We elected to adopt the updated standard for the purpose of our goodwill impairment testing in the fourth fiscal quarter of 2011.

In the fourth fiscal quarter of 2011, we completed the annual impairment test of goodwill. We assessed whether it was more likely than not (that is, a likelihood of more than 50%) that each reporting unit's fair value was less than its carrying amount including goodwill by considering the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in our share price. Based on these factors and the recent impairment testing in the second fiscal quarter of 2011, we determined that it is not more likely than not that each reporting unit's fair value was less than its carrying amount, and therefore performing the first step of the two-step impairment test for each reporting unit was unnecessary. No goodwill impairment was recognized in the years ended December 31, 2011, 2010 or 2009. We do not believe it is likely that there will be a material change in the estimates or assumptions we use to test for impairment losses on goodwill. However, if the actual results are not consistent with our estimates or assumptions, we may be exposed to an impairment charge that could be material.

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from less than one year to ten years. Purchased intangible assets determined to have indefinite useful lives are not amortized. Long-lived assets, including property and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Such conditions may include an economic downturn or a

## **Table of Contents**

change in the assessment of future operations. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

During the years ended December 31, 2011, 2010 and 2009, there were no events or changes in circumstances that indicated the carrying amount of our long-lived assets may not be recoverable from their undiscounted cash flows. Consequently, we did not perform an impairment test or record an impairment of our long-lived assets during those periods.

We will continue to evaluate the carrying value of our long-lived assets and if we determine in the future that there is a potential further impairment, we may be required to record additional charges to earnings which could affect our financial results.

## ***Income Taxes***

We account for income taxes under an asset and liability approach. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences resulting from different treatments for tax versus accounting of certain items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. As of December 31, 2011, we believe that all of our deferred tax assets are recoverable; however, if there were a change in our ability to recover our deferred tax assets, we would be required to take a charge in the period in which we determined that recovery was not more likely than not.

Uncertain tax provisions are recognized under guidance that provides that a company should use a more-likely-than-not recognition threshold based on the technical merits of the income tax position taken. Income tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. We include interest expense and penalties related to uncertain tax positions as additional tax expense.

**Table of Contents****Results of Operations**

The following table sets forth the Consolidated Statements of Operations and the percentage change from the preceding year for the periods indicated:

	Year Ended December 31,		Year Ended December 31,		2009
	2011	Percentage Change	2010	Percentage Change	
	(In thousands, except percentage data)				
Net revenue	\$ 1,181,018	30.9%	\$ 902,052	31.4%	\$ 686,595
Cost of revenue	811,572	34.6%	602,805	25.5%	480,195
Gross profit	369,446	23.5%	299,247	45.0%	206,400
Operating expenses:					
Research and development	48,699	21.8%	39,972	33.0%	30,056
Sales and marketing	154,562	17.5%	131,570	23.9%	106,162
General and administrative	39,423	8.8%	36,220	10.7%	32,727
Restructuring and other charges	2,094	**	(88)	**	809
Technology license arrangements		**		(100.0%)	2,500
Litigation reserves, net	(201)	**	211	(89.9%)	2,080
Total operating expenses	244,577	17.7%	207,885	19.2%	174,334
Income from operations	124,869	36.7%	91,362	184.9%	32,066
Interest income, net	477	12.0%	426	(32.3%)	629
Other income (expense), net	(1,136)	101.4%	(564)	340.6%	(128)
Income before income taxes	124,210	36.2%	91,224	180.1%	32,567
Provision for income taxes	32,842	(18.5%)	40,315	73.5%	23,234
Net income	\$ 91,368	79.5%	\$ 50,909	445.5%	\$ 9,333

\*\* Percentage change not meaningful.

The following table sets forth the Consolidated Statements of Operations, expressed as a percentage of net revenue, for the periods presented:

	Year Ended December 31,		
	2011	2010	2009
Net revenue	100%	100%	100%
Cost of revenue	68.7	66.8	69.9
Gross margin	31.3	33.2	30.1
Operating expenses:			
Research and development	4.1	4.5	4.4
Sales and marketing	13.1	14.6	15.4
General and administrative	3.3	4.0	4.8
Restructuring and other charges	0.2	0.0	0.1
Technology license arrangements	0.0	0.0	0.4

Edgar Filing: NETGEAR, INC - Form 10-K

Litigation reserves, net	0.0	0.0	0.3
Total operating expenses	20.7	23.1	25.4
Income from operations	10.6	10.1	4.7
Interest income, net	0.0	0.1	0.1
Other income (expense), net	(0.1)	(0.1)	(0.1)
Income before income taxes	10.5	10.1	4.7
Provision for income taxes	2.8	4.5	3.3
Net income	7.7%	5.6%	1.4%

**Table of Contents****Net Revenue**

	Year Ended December 31,		Year Ended December 31,		2009
	2011	Percentage Change	2010	Percentage Change	
	(In thousands, except percentage data)				
Net revenue	\$ 1,181,018	30.9%	\$ 902,052	31.4%	\$ 686,595

Our net revenue consists of gross product shipments, less allowances for estimated returns for stock rotation and warranty, price protection, end-user customer rebates and other sales incentives deemed to be a reduction of net revenue and net changes in deferred revenue.

**2011 Net Revenue Compared to 2010 Net Revenue**

Net revenue increased \$278.9 million, or 30.9%, to \$1.2 billion for the year ended December 31, 2011, from \$902.1 million for the year ended December 31, 2010. The increase in net revenue was due to strong growth in our retail and commercial product lines, and exceptional growth in service provider revenue. Refer to the discussion of segment information for additional discussion of net revenue by business unit.

In the first quarter of 2011, in order to achieve operational efficiencies, we combined our North American, Central American and South American sales forces to form the Americas territory. Previously North America was its own geographic region and the Central American and South American territories were categorized within the Asia Pacific geographic region. Following this change, we are organized into the following three geographic territories: Americas, EMEA and Asia Pacific. We have reclassified the disclosure of net revenue by geography for prior periods to conform to the current period's presentation. The change did not result in material differences from what was previously reported. Net revenue by geography comprises gross revenue less such items as marketing incentives paid to customers, sales returns and price protection.

Net revenue by geographic location is as follows:

	Twelve Months Ended		December 31, 2010
	December 31, 2011	Percentage Change	
	(In thousands, except percentage data)		
Americas	\$ 587,056	25.8%	\$ 466,542
<i>Percentage of net revenue</i>	<i>49.7%</i>		<i>51.7%</i>
Europe, Middle-East and Africa	\$ 477,713	40.4%	\$ 340,249
<i>Percentage of net revenue</i>	<i>40.4%</i>		<i>37.7%</i>
Asia Pacific	\$ 116,249	22.0%	\$ 95,261
<i>Percentage of net revenue</i>	<i>9.8%</i>		<i>10.6%</i>

**2010 Net Revenue Compared to 2009 Net Revenue**

We experienced very strong net revenue growth from 2009 to 2010. The increase in net revenue was primarily due to exceptional growth in our retail and commercial product lines, while service provider revenue was down slightly. Refer to the discussion in the *Segment Information* section for additional discussion of net revenue by business unit.



**Table of Contents**

Net revenue by geographic location is as follows:

	December 31, 2010	Twelve Months Ended Percentage Change	December 31, 2009
(In thousands, except percentage data)			
Americas	\$ 466,542	46.4%	\$ 318,573
<i>Percentage of net revenue</i>	<i>51.7%</i>		<i>46.4%</i>
Europe, Middle-East and Africa	\$ 340,249	16.4%	\$ 292,340
<i>Percentage of net revenue</i>	<i>37.7%</i>		<i>42.6%</i>
Asia Pacific	\$ 95,261	25.9%	\$ 75,682
<i>Percentage of net revenue</i>	<i>10.6%</i>		<i>11.0%</i>
<b>Cost of Revenue and Gross Margin</b>			

	2011	Year Ended December 31, Percentage Change	2010	Percentage Change	2009
(In thousands, except percentage data)					
Cost of revenue	\$ 811,572	34.6%	\$ 602,805	25.5%	\$ 480,195
<i>Gross margin percentage</i>	<i>31.3%</i>		<i>33.2%</i>		<i>30.1%</i>

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; inbound freight; warranty costs associated with returned goods; write-downs for excess and obsolete inventory; and amortization expense of certain acquired intangibles. 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 net revenues due to changes in average selling prices, end-user customer rebates and other sales incentives, and changes in our cost of goods sold due to fluctuations in prices paid for components, net of vendor rebates, warranty and overhead costs, inbound freight, conversion costs, and charges for excess or obsolete inventory.

**2011 Cost of Revenue and Gross Margin Compared to 2010 Cost of Revenue and Gross Margin**

Cost of revenue increased \$208.8 million, or 34.6%, to \$811.6 million for the year ended December 31, 2011, from \$602.8 million for the year ended December 31, 2010. Our gross margin decreased to 31.3% for the year ended December 31, 2011, from 33.2% for the year ended December 31, 2010.

The decrease in gross margin was primarily attributable to a higher percentage of our total revenue derived from sales to service providers, which generally carry lower gross margins. For the years ended December 31, 2011 and 2010, the sales from service providers represented 31% and 20% of net revenue, respectively.

**2010 Cost of Revenue and Gross Margin Compared to 2009 Cost of Revenue and Gross Margin**

Cost of revenue increased \$122.6 million, or 25.5%, to \$602.8 million for the year ended December 31, 2010, from \$480.2 million for the year ended December 31, 2009. Our gross margin increased to 33.2% for the year ended December 31, 2010, from 30.1% for the year ended December 31, 2009.

The increase in gross margin was primarily attributable to a higher percentage of our total revenue coming from higher sales of retail and commercial business products, which generally carry higher gross margins. For the years ended December 31, 2010 and 2009, the sales from service providers represented 20% and 27% of net revenue, respectively.



**Table of Contents****Operating Expenses****Research and Development Expense**

	Year Ended December 31,				2009
	2011	Percentage Change	2010	Percentage Change	
	(In thousands, except percentage data)				
Research and development expense	\$ 48,699	21.8%	\$ 39,972	33.0%	\$ 30,056
<i>Percentage of net revenue</i>	4.1%		4.5%		4.4%

Research and development expenses consist 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 and other consulting fees. Research and development expenses are recognized as they are incurred. We have invested in building our research and development organization to enhance our ability to introduce innovative and easy-to-use products. In the future, we believe that research and development expenses will increase in absolute dollars as we expand into new networking product technologies and broaden our core competencies.

**2011 Research and Development Expense Compared to 2010 Research and Development Expense**

Research and development expenses increased \$8.7 million, or 21.8%, to \$48.7 million for the year ended December 31, 2011, from \$40.0 million for the year ended December 31, 2010. The increase was primarily attributable to increased costs of \$5.5 million related to an increase in payroll and other employee expenses driven by additional headcount. Research and development headcount increased by 46 employees to 224 employees at December 31, 2011 compared to 178 employees at December 31, 2010. Furthermore, the increase was attributable to higher outside service costs of \$2.5 million, primarily related to our increased research and development projects.

**2010 Research and Development Expense Compared to 2009 Research and Development Expense**

Research and development expenses increased \$9.9 million, or 33.0%, to \$40.0 million for the year ended December 31, 2010, from \$30.1 million for the year ended December 31, 2009. The increase was primarily attributable to increased costs of \$7.2 million related to an increase in payroll and other employee expenses principally resulting from increased variable compensation, as well as increased overall research and development headcount. Research and development headcount increased by 29 employees to 178 employees at December 31, 2010, compared to 149 employees at December 31, 2009. We note there was minimal variable compensation expense in the year ended December 31, 2009. Also included in the \$9.9 million was an increase of \$646,000 due to acquisition-related contingent compensation related to our May 2007 acquisition of Infrant Technologies, Inc. earned during the year ended December 31, 2010 that did not occur during the year ended December 31, 2009. Furthermore, the increase was attributable to higher outside service costs of \$1.2 million, primarily related to our increased research and development projects.

**Sales and Marketing Expense**

	Year Ended December 31,				2009
	2011	Percentage Change	2010	Percentage Change	
	(In thousands, except percentage data)				
Sales and marketing expense	\$ 154,562	17.5%	\$ 131,570	23.9%	\$ 106,162
<i>Percentage of net revenue</i>	13.1%		14.6%		15.4%

Sales and marketing expenses consist primarily of advertising, trade shows, corporate communications and other marketing expenses, product marketing expenses, outbound freight costs, personnel expenses for sales and marketing staff and technical support expenses.

**Table of Contents****2011 Sales and Marketing Expense Compared to 2010 Sales and Marketing Expense**

Sales and marketing expenses increased \$23.0 million, or 17.5%, to \$154.6 million for the year ended December 31, 2011, from \$131.6 million for the year ended December 31, 2010. Of this increase, \$13.8 million was related to an increase in payroll and other employee expenses primarily attributable to increased overall sales and marketing headcount. Sales and marketing headcount increased by 54 employees to 357 employees at December 31, 2011 compared to 303 employees at December 31, 2010. Further, \$7.2 million of the increase was due to marketing costs resulting from increased marketing campaigns, and call center and freight costs, resulting from greater sales volumes.

**2010 Sales and Marketing Expense Compared to 2009 Sales and Marketing Expense**

Sales and marketing expenses increased \$25.4 million, or 23.9%, to \$131.6 million for the year ended December 31, 2010, from \$106.2 million for the year ended December 31, 2009. Of this increase, \$15.1 million was related to an increase in payroll and other employee expenses primarily attributable to increased overall sales and marketing headcount, increased variable compensation and an increase in travel expenses. Sales and marketing headcount increased by 35 employees to 303 employees at December 31, 2010, compared to 268 employees at December 31, 2009. Additionally, marketing expenses and other outside service costs increased by \$6.8 million due to increased marketing campaigns.

**General and Administrative Expense**

	Year Ended December 31,				
	2011	Percentage Change	2010	Percentage Change	2009
	(In thousands, except percentage data)				
General and administrative expense	\$ 39,423	8.8%	\$ 36,220	10.7%	\$ 32,727
Percentage of net revenue	3.3%		4.0%		4.8%

General and administrative expenses consist of salaries and related expenses for executive, finance and accounting, human resources, professional fees, allowance for doubtful accounts and other corporate expenses.

**2011 General and Administrative Expense Compared to 2010 General and Administrative Expense**

General and administrative expenses increased \$3.2 million, or 8.8%, to \$39.4 million for the year ended December 31, 2011, from \$36.2 million for the year ended December 31, 2010. The increase was primarily due to an increase in payroll and other employee expenses primarily attributable to increased headcount. General and administrative headcount increased by 16 employees to 114 employees at December 31, 2011 compared to 98 employees at December 31, 2010.

**2010 General and Administrative Expense Compared to 2009 General and Administrative Expense**

General and administrative expenses increased \$3.5 million, or 10.7%, to \$36.2 million for the year ended December 31, 2010, from \$32.7 million for the year ended December 31, 2009. Of this amount, \$6.1 million was related to an increase in payroll and other employee expenses primarily attributable to increased variable compensation. We note there was minimal variable compensation expense in the year ended December 31, 2009. Partially offsetting this increase was a \$2.4 million decrease in fees for outside legal and other professional services primarily attributable to decreased legal patent defense costs.

**Restructuring and Other Charges**

Restructuring and other charges increased \$2.2 million, to an expense of \$2.1 million during the year ended December 31, 2011, from a benefit of \$88,000 for year ended December 31, 2010. Of the \$2.2 million increase, we incurred \$1.6 million in restructuring costs for employee severance related to the reorganization into three

**Table of Contents**

specific business units during the year ended December 31, 2011. In addition, we incurred \$464,000 in transition services in connection with the acquisition of the Customer Networking Solutions division of Westell Technologies, Inc. during the year ended December 31, 2011. For a further discussion of our restructuring expenses, please see Note 4, *Restructuring and Other Charges*, of the Notes to Consolidated Financial Statements.

In July 2008, we ceased using buildings leased in Santa Clara and Fremont, California, and consolidated all personnel and operations from those locations to our new corporate headquarters in San Jose, California. The last of these operating leases expired in December 2010. During the year ended December 31, 2010, we realized a benefit of \$88,000 related to these facilities in Santa Clara and Fremont due to lower than expected common area maintenance fees. During the year ended December 31, 2009, we expensed \$809,000 related to these excess facilities. For a detailed discussion of our restructuring expenses, please see Note 4, *Restructuring and Other Charges*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

**Technology License Arrangements**

We did not incur any expenses related to technology license arrangements in the years ended December 31, 2011 and 2010.

During the year ended December 31, 2009, we entered into a \$2.5 million arrangement to license software technologies that we may integrate into certain future products. At that time, we had not yet established the technological feasibility of these products, and we did not believe the software had an alternative future use. As such, we expensed the entire technology license arrangement amount of \$2.5 million in the year ended December 31, 2009.

**Litigation Reserves and Payments**

During the year ended December 31, 2011, we recorded a litigation reserve benefit of \$201,000 for estimated costs related to the settlement of potential lawsuits or lawsuits already filed against us. For a detailed discussion of our litigation matters, please see Note 9, *Commitments and Contingencies*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

During the year ended December 31, 2010, we recorded a litigation reserve expense of \$211,000 for estimated costs related to the settlement of potential lawsuits or lawsuits already filed against us.

During the year ended December 31, 2009, we recorded net litigation reserves expense of \$2.1 million. This expense was primarily comprised of \$2.6 million in estimated costs related to the settlement of various lawsuits against us, which includes \$2.1 million related to a one-time settlement payment made to the Commonwealth Scientific and Industrial Research Organization ( CSIRO ) and \$350,000 related to a one-time settlement payment made to Network-1 Security Solutions, Inc. ( Network-1 ). These expenses were offset by a reduction in previously accrued legal settlement costs of \$500,000 due to a summary judgment ruling in our favor on another case.

**Interest Income and Other Income (Expense)**

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
<b>Interest income and other income (expense)</b>			
Interest income, net	\$ 477	\$ 426	\$ 629
Other income (expense), net	(1,136)	(564)	(128)
Total interest income and other income (expense)	\$ (659)	\$ (138)	\$ 501

---

## **Table of Contents**

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 and other miscellaneous expenses.

### ***2011 Interest Income and Other Income (Expense) Compared to 2010 Interest Income and Other Income (Expense)***

Interest income increased \$51,000, or 12.0%, to \$477,000 for the year ended December 31, 2011, from \$426,000 for the year ended December 31, 2010. The increase in interest income was primarily attributable to an increase in our average balance of cash, cash equivalents, and short-term investments during the year ended December 31, 2011, as compared to the year ended December 31, 2010, which was partially offset by falling interest rates.

Other expense, net, increased \$572,000 to expense of \$1.1 million for year ended December 31, 2011, from expense of \$564,000 for year ended December 31, 2010. Our foreign currency hedging program reduced volatility associated with hedged currency exchange rate movements during the year ended December 31, 2011. The expense of \$1.1 million mainly related to forward points for hedged currency. For details of our hedging program and related foreign currency contracts, please see Note 5, *Derivative Financial Instruments*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

### ***2010 Interest Income and Other Income (Expense) Compared to 2009 Interest Income and Other Income (Expense)***

Interest income decreased \$203,000, or 32.3%, to \$426,000 for the year ended December 31, 2010, from \$629,000 for the year ended December 31, 2009. The decrease in interest income was primarily attributable to a decrease in the average interest rate earned in the year ended December 31, 2010, as compared to the year ended December 31, 2009.

Other expense, net, increased \$436,000 to expense of \$564,000 for year ended December 31, 2010, from expense of \$128,000 for year ended December 31, 2009. Our foreign currency hedging program reduced volatility associated with hedged currency exchange rate movements during the year ended December 31, 2010. The expense of \$564,000 is primarily related to exposures in currencies that are not included in our hedging program. For details of our hedging program and related foreign currency contracts, please see Note 5, *Derivative Financial Instruments*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

## **Provision for Income Taxes**

### ***2011 Provision for Income Taxes Compared to 2010 Provision for Income Taxes***

Provision for income taxes decreased \$7.5 million, resulting in a provision of \$32.8 million for the year ended December 31, 2011, compared to a provision of \$40.3 million for the year ended December 31, 2010. The effective tax rate decreased to 26.4% for the year ended December 31, 2011 from 44.2% for the year ended December 31, 2010. The effective tax rate for both periods differed from the statutory rate of 35% due to state taxes, other non-deductible expenses, and tax credits. Non-deductible expenses in the year ended December 31, 2010 included certain stock based compensation. For the year ended December 31, 2011, tax on earnings from foreign operations reduced the effective tax rate by 9.5 percentage points compared to an increase of 5.1 percentage points for 2010. The tax rate benefit of earnings from foreign operations in 2011 resulted from improvements in profitability of international operations located in tax jurisdictions with rates below 35%. In 2011, state income taxes increased the effective tax rate by 1.5 percentage points compared to an increase of 4.2 percentage points for 2010. The lower impact of state taxes in 2011 compared to 2010 was primarily due to a legislation that was effective as of January 1, 2011 that provided for a more favorable methodology for computing the amount of income subject to tax in California.

**Table of Contents****2010 Provision for Income Taxes Compared to 2009 Provision for Income Taxes**

Provision for income taxes increased \$17.1 million, resulting in a provision of \$40.3 million for the year ended December 31, 2010, compared to a provision of \$23.2 million for the year ended December 31, 2009. The effective tax rate decreased to 44.2 % for the year ended December 31, 2010 from 71.3% for the year ended December 31, 2009. The effective tax rate for both periods differed from the statutory rate of 35% due to non-deductible stock-based compensation, state taxes, other non-deductible expenses, and tax credits. Additionally, in 2010 tax attributable to foreign operations increased the effective tax rate by 5.1 percentage points compared to an increase of 28.4 percentage points for 2009. In both years, this was primarily caused by the tax effect of non-deductible losses in foreign jurisdictions where no benefit could be claimed. The unfavorable rate impact of foreign operations was lower in 2010 compared with 2009 because of improvements in both international and worldwide earnings.

**Net Income**

Net income increased \$40.5 million to \$91.4 million for the year ended December 31, 2011, from \$50.9 million for the year ended December 31, 2010. This increase was primarily attributable to an increase in gross profit of \$70.2 million and a decrease in provision for income taxes of \$7.5 million. This increase was partially offset by an increase in operating expenses of \$36.7 million.

Net income increased \$41.6 million to \$50.9 million for the year ended December 31, 2010, from \$9.3 million for the year ended December 31, 2009. This increase was primarily attributable to an increase in gross profit of \$92.8 million. This increase was partially offset by an increase in operating expenses of \$33.6 million and an increase in the provision for income taxes of \$17.1 million.

**Segment Information**

A description of our products and services, as well as segment financial data, for each segment can be found in Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K. Future changes to our organizational structure or business may result in changes to the reportable segments disclosed.

Segment contribution income includes all product line segment net 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, general and administrative costs, stock-based compensation expenses, amortization of intangibles, acquisition-related integration costs, restructuring costs, litigation reserves, and interest and other income (expense), net. A reconciliation of segment contribution income to income before income taxes can be found in Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

**Retail**

	Year Ended December 31,				
	2011	Percent Change	2010	Percent Change	2009
	( in thousands, except percentage data)				
Net revenue	\$ 481,795	10.6%	\$ 435,484	50.8%	\$ 288,728
Contribution income	81,589	13.5%	71,862	188.6%	24,901
Contribution margin	16.9%		16.5%		8.6%

**Table of Contents*****2011 Net Retail Revenue and Contribution Income Compared to 2010 Retail Net Revenue and Contribution Income***

We experienced strong net revenue growth in the retail business unit from 2010 to 2011. The increase was mainly driven by a 34.5% increase in the revenue from our home wireless-N product line due to consumers transitioning from wireless-G to wireless-N technology. We also experienced strong growth in contribution income. The increase in contribution income was primarily due to revenue growth and an increase in gross margin, which was mainly driven by a decrease in freight costs due to a favorable shift from air to sea freight. Net revenue increased by 10.6% and retail-related gross profit increased by 15.0% over the same period. The impact of the increase in gross profit was partially offset by an increase in retail-related operating expenses, which increased by 16.7% over the same period.

***2010 Net Retail Revenue and Contribution Income Compared to 2009 Net Retail Revenue and Contribution Income***

We experienced exceptional net revenue growth in the retail business unit from 2009 to 2010. The increase was driven by an increase in consumer demand across almost all of our product lines. In particular, revenue from our home wireless-N product line increased by 167.6% due to consumers transitioning from wireless-G to wireless-N technology. We also experienced exceptional growth in contribution income. The increase in contribution income was primarily due to revenue growth, while the increase in operating expenses was moderate. Net revenue increased by 50.8%, while retail-related operating expenses increased by only 11.1% over the same period.

**Commercial**

	Year Ended December 31,				
	2011	Percent Change	2010	Percent Change	2009
	( in thousands, except percentage data)				
Net revenue	\$ 331,439	16.5%	\$ 284,539	35.5%	\$ 209,953
Contribution income	74,746	18.6%	63,021	45.7%	43,255
Contribution margin	22.6%		22.1%		20.6%

***2011 Net Commercial Revenue and Contribution Income Compared to 2010 Commercial Net Revenue and Contribution Income***

We experienced strong net revenue growth in the commercial business unit from 2010 to 2011. The increase was driven by an increase in demand across our product lines. In particular, revenue from our network storage product line and switch products increased by 15.1% and 18.6%, respectively. We also experienced strong growth in contribution income. The increase in contribution income was primarily due to revenue growth, while the increase in operating expenses was moderate. Net revenue increased by 16.5%, while commercial-related operating expenses increased by only 13.0% over the same period.

***2010 Net Commercial Revenue and Contribution Income Compared to 2009 Commercial Net Revenue and Contribution Income***

We experienced exceptional net revenue growth in the commercial business unit from 2009 to 2010. The increase was driven by an increase in demand across all of our product lines. In particular, revenue from our network storage product line and switch products increased by 51.3% and 34.1%, respectively. We also experienced exceptional growth in contribution income. The increase in contribution income was primarily due to revenue growth and a slight increase in gross margin, which was driven by favorable product mix and a decrease in freight costs. Commercial-related operating expenses increased in line with the increase in gross profit.



**Table of Contents****Service Provider**

	Year Ended December 31,				
	2011	Percent Change	2010	Percent Change	2009
	(in thousands, except percentage data)				
Net revenue	\$ 367,784	102.0%	\$ 182,029	(3.1%)	\$ 187,914
Contribution income	32,797	133.8%	14,026	(28.8%)	19,697
Contribution margin	8.9%		7.7%		10.5%

**2011 Net Service Provider Revenue and Contribution Income Compared to 2010 Service Provider Net Revenue and Contribution Income**

We experienced exceptional net revenue growth in the service provider unit from 2010 to 2011. The increase was primarily driven by the adoption of Docsis 3.0 products. We also experienced exceptional growth in contribution income. The increase in contribution income was primarily due to revenue growth, while the increase in operating expenses was moderate. Net revenue increased by 102.0%, while service-provider-related operating expenses increased by only 48.1%, due to an increase in research and development and sales and marketing, over the same period.

**2010 Net Service Provider Revenue and Contribution Income Compared to 2009 Service Provider Net Revenue and Contribution Income**

Net revenue in the service provider business unit was down slightly from 2009 to 2010, as service provider customers paused in anticipation of adopting Docsis 3.0. Contribution income also decreased from 2009 to 2010. The decrease in contribution income was primarily due to the decrease in revenue and an increase in service-provider-related operating expenses. Net revenue decreased by 3.1%, while service-provider-related operating expenses increased by 20.2%, driven primarily by an increase in research and development spending.

**Liquidity and Capital Resources**

As of December 31, 2011, we had cash, cash equivalents and short-term investments totaling \$353.7 million.

Our cash and cash equivalents balance increased from \$126.2 million as of December 31, 2010 to \$208.9 million as of December 31, 2011. Our short-term investments, which represent the investment of funds available for current operations, increased from \$144.6 million as of December 31, 2010 to \$144.8 million as of December 31, 2011, as we shifted assets from money market funds to Treasuries with higher returns. Operating activities during the year ended December 31, 2011, generated cash of \$96.0 million. Investing activities during the year ended December 31, 2011 used \$46.9 million, which includes the net purchases of short-term investments of \$1.2 million, payments made in connection with business acquisitions of \$37.5 million, primarily the Westell acquisition, and purchases of property and equipment of \$8.2 million. During the year ended December 31, 2011, financing activities provided \$33.6 million, primarily due to the issuance of our common stock upon exercise of stock options and our employee stock purchase program, as well as the excess tax benefit from exercises and cancellations of stock options.

Our days sales outstanding decreased from 78 days as of December 31, 2010 to 76 days as of December 31, 2011.

Our accounts payable increased from \$89.2 million at December 31, 2010 to \$117.3 million at December 31, 2011 primarily as a result of timing of payments.

Inventory increased by \$36.3 million from \$127.4 million at December 31, 2010 to \$163.7 million at December 31, 2011. Ending inventory turns decreased from 5.6 turns in the three months ended December 31, 2010, to 5.2 turns in the three months ended December 31, 2011. This decrease is primarily attributable to our increased inventory levels to support current and expected demand levels for our products, and an increase in deferred revenue from December 31, 2010 to December 31, 2011.

---

**Table of Contents**

We enter into foreign currency forward-exchange contracts, which typically mature in three to five 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 sheet 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 in 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 cumulative other comprehensive income until the related revenue, costs of revenue, or expenses are recognized.

In October 21, 2008, the Board of Directors authorized management to repurchase up to 6,000,000 shares of our outstanding common stock. Under this authorization, 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. We did not repurchase any shares under this authorization during the years ended December 31, 2011, 2010 or 2009.

We also repurchase shares to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs throughout the year. We repurchased approximately 25,000 shares, or \$926,000 of common stock to facilitate tax withholdings for RSUs during the year ended December 31, 2011. Similarly, during the years ended December 31, 2010 and December 31, 2009, we repurchased approximately 32,000 shares and 22,000 shares, respectively, or \$736,000 and \$282,000 of our common stock, respectively, to help facilitate tax withholding for RSUs. These shares were retired upon repurchase.

Based on our current plans and market conditions, we believe that our existing cash, cash equivalents and short-term investments will be sufficient to satisfy our anticipated cash requirements for the foreseeable future. However, we cannot be certain that our planned levels of revenue, costs and expenses will be achieved. If our operating results fail to meet our expectations or if we fail to manage our inventory, accounts receivable or other assets, we could be required to seek additional funding through public or private financings or other arrangements. In addition, as we continue to expand our product offerings, channels and geographic presence, we may require additional working capital. In such event, adequate funds may not be available when needed or may not be available on favorable or commercially acceptable terms, which could have a negative effect on our business and results of operations.

**Backlog**

As of December 31, 2011, we had a backlog of approximately \$128.5 million, compared to approximately \$82.4 million as of December 31, 2010, primarily due to product demand required in the future. Our backlog consists of products for which customer purchase orders have been received and that are scheduled or in the process of being scheduled for shipment. While we expect to fulfill the order backlog within the current year, most orders are subject to rescheduling or cancellation with little or no penalties. Because of the possibility of customer changes in product scheduling or order cancellation, our backlog as of any particular date may not be an indicator of net sales for any succeeding period.

**Table of Contents****Contractual Obligations and Off-Balance Sheet Arrangements****Contractual Obligations**

The following table describes our commitments to settle non-cancelable lease and purchase commitments as of December 31, 2011.

	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	Total
	(In thousands)				
<b>Operating leases</b>	\$ 6,349	\$ 9,753	\$ 7,539	\$ 6,071	\$ 29,712
<b>Purchase obligations</b>	\$ 139,411	\$	\$	\$	\$ 139,411
	\$ 145,760	\$ 9,753	\$ 7,539	\$ 6,071	\$ 169,123

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense was \$7.0 million for the year ended December 31, 2011, \$6.4 million for the year ended December 31, 2010, and \$6.2 million for the year ended December 31, 2009. The terms of some of the office leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period, and have accrued for rent expense incurred but not paid. 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.

We enter into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of the orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are not cancelable within 30 days prior to the expected shipment date. At December 31, 2011, we had \$139.4 million in non-cancelable purchase commitments with suppliers. We expect to sell all products for which we have committed purchases from suppliers.

As of December 31, 2011 and December 31, 2010, we had \$18.7 million and \$19.8 million, respectively, of total gross unrecognized tax benefits and related interest. The timing of any payments that could result from these unrecognized tax benefits will depend upon a number of factors. Accordingly, the timing of payment cannot be estimated. The possible reduction in liabilities for uncertain tax positions in multiple jurisdictions in the next 12 months is approximately \$1.0 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

**Off-Balance Sheet Arrangements**

As of December 31, 2011, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Recent Accounting Pronouncements**

See Note 1, *The Company and Summary of Significant Accounting Policies*, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, 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.

---

**Table of Contents****Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***  
**Interest Rate Risk**

We do not use derivative financial instruments in our investment portfolio. We have an investment portfolio of fixed income securities that are classified as available-for-sale securities. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in highly rated short-term securities. Our investment policy requires investments to be rated triple-A with the objective of minimizing the potential risk of principal loss. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% by market interest rates would not have a material impact on our operating results and the total value of the portfolio over the next fiscal year. We monitor our interest rate and credit risks, including our credit exposure to specific rating categories and to individual issuers. There were no impairment charges on our investments during fiscal 2011.

**Foreign Currency Transaction Risk**

We invoice some of our international customers in foreign currencies including, but not limited to, the Australian dollar, British pound, euro, and Japanese yen. As the customers that are currently invoiced in local currency become a larger percentage of our business, or to the extent we begin to bill additional customers in foreign currencies, the impact of fluctuations in foreign exchange rates could have a more significant impact on our results of operations. For those customers in our international markets that we continue to sell to in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand for our products could reduce sales and negatively impact our operating results. Certain operating expenses of our foreign operations require payment in the local currencies.

We are exposed to risks associated with foreign exchange rate fluctuations due to our international sales and operating activities. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. We began using foreign currency forward contract derivatives in the fourth quarter of 2008 to partially offset our business exposure to foreign exchange risk on our foreign currency denominated assets and liabilities. Additionally, in the second quarter of 2009 we began entering into certain foreign currency forward contracts that have been designated as cash flow hedges under the authoritative guidance for derivatives and hedging to partially offset our business exposure to foreign exchange risk on portions of our anticipated foreign currency revenue, costs of revenue, and certain operating expenses. The objective of these foreign currency forward contracts is to reduce the impact of currency exchange rate movements on our operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The contracts are marked-to-market on a monthly basis with gains and losses included in other income (expense), net in the Consolidated Statements of Operations, and in cumulative other comprehensive income on the Consolidated Balance Sheets. We do not use foreign currency contracts for speculative or trading purposes. Hedging of our balance sheet and anticipated cash flow exposures may not always be effective to protect us against currency exchange rate fluctuations. In addition, we do not fully hedge our balance sheet and anticipated cash flow exposures, leaving us at risk to foreign exchange gains and losses on the un-hedged exposures. If there were an adverse movement in exchange rates, we might suffer significant losses. See Note 5, *Derivative Financial Instruments*, of the Notes to Consolidated Financial Statements for additional disclosure on our foreign currency contracts, which are hereby incorporated by reference into this Part II, Item 7A.

As of December 31, 2011, we had net assets in various local currencies. A hypothetical 10% movement in foreign exchange rates would result in an after-tax positive or negative impact of \$232,000 to net income, net of our hedged position, at December 31, 2011. Actual future gains and losses associated with our foreign currency exposures and positions may differ materially from the sensitivity analyses performed as of December 31, 2011 due to the inherent limitations associated with predicting the foreign currency exchange rates, and our actual exposures and positions. For the year ended December 31, 2011, 13% of total net revenue was denominated in a currency other than the U.S. dollar.

---

**Table of Contents**

**Item 8. Consolidated Financial Statements and Supplementary Data**  
**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of NETGEAR, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a) (1) present fairly, in all material respects, the financial position of NETGEAR, Inc. and its subsidiaries at December 31, 2011 and December 31, 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Jose, CA

February 29, 2012

**Table of Contents****NETGEAR, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share data)**

	<b>December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 208,898	\$ 126,173
Short-term investments	144,797	144,564
Accounts receivable, net	261,307	226,731
Inventories	163,724	127,394
Deferred income taxes	23,088	19,332
Prepaid expenses and other current assets	32,415	23,850
<b>Total current assets</b>	<b>834,229</b>	<b>668,044</b>
Property and equipment, net	15,884	17,503
Intangibles, net	20,956	6,241
Goodwill	85,944	74,198
Other non-current assets	14,357	14,335
<b>Total assets</b>	<b>\$ 971,370</b>	<b>\$ 780,321</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 117,285	\$ 89,155
Accrued employee compensation	26,896	24,130
Other accrued liabilities	120,480	110,413
Deferred revenue	40,093	27,538
Income taxes payable	4,207	3,487
<b>Total current liabilities</b>	<b>308,961</b>	<b>254,723</b>
Non-current income taxes payable	18,657	19,719
Other non-current liabilities	4,995	5,443
<b>Total liabilities</b>	<b>332,613</b>	<b>279,885</b>
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock: \$0.001 par value; 5,000,000 shares authorized; none issued or outstanding.		
Common stock: \$0.001 par value; 200,000,000 shares authorized; shares issued and outstanding: 37,646,872 and 36,173,406 at December 31, 2011 and 2010, respectively.	38	36
Additional paid-in capital	364,243	316,108
Cumulative other comprehensive income	23	281
Retained earnings	274,453	184,011
<b>Total stockholders' equity</b>	<b>638,757</b>	<b>500,436</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 971,370</b>	<b>\$ 780,321</b>

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



**Table of Contents****NETGEAR, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)**

	Year Ended December 31,		
	2011	2010	2009
Net revenue	\$ 1,181,018	\$ 902,052	\$ 686,595
Cost of revenue	811,572	602,805	480,195
Gross profit	369,446	299,247	206,400
Operating expenses:			
Research and development	48,699	39,972	30,056
Sales and marketing	154,562	131,570	106,162
General and administrative	39,423	36,220	32,727
Restructuring and other charges	2,094	(88)	809
Technology license arrangements			2,500
Litigation reserves, net	(201)	211	2,080
Total operating expenses	244,577	207,885	174,334
Income from operations	124,869	91,362	32,066
Interest income, net	477	426	629
Other income (expense), net	(1,136)	(564)	(128)
Income before income taxes	124,210	91,224	32,567
Provision for income taxes	32,842	40,315	23,234
Net income	\$ 91,368	\$ 50,909	\$ 9,333
Net income per share:			
Basic	\$ 2.46	\$ 1.44	\$ 0.27
Diluted	\$ 2.41	\$ 1.41	\$ 0.27
Weighted average shares outstanding used to compute net income per share:			
Basic	37,121	35,385	34,485
Diluted	37,932	36,124	34,848

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



**Table of Contents****NETGEAR, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(In thousands)

	Common Stock		Additional Paid-In Capital	Cumulative Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount				
<b>Balance at December 31, 2008</b>	34,280	\$ 34	\$ 266,070	\$ 67	\$ 124,787	\$ 390,958
Comprehensive income:						
Change in unrealized gains and losses on available-for-sale securities, net of tax				(63)		(63)
Change in unrealized gains and losses on derivatives, net of tax				20		20
Net income					9,333	9,333
Total comprehensive income						9,290
Stock-based compensation expense			11,059			11,059
Purchase and retirement of common stock	(21)				(282)	(282)
Issuance of common stock under stock-based compensation plans	474	1	2,991			2,992
Tax benefit from exercises and cancellations of stock options			136			136
<b>Balance at December 31, 2009</b>	34,733	35	280,256	24	133,838	414,153
Comprehensive income:						
Change in unrealized gains and losses on available-for-sale securities, net of tax				4		4
Change in unrealized gains and losses on derivatives, net of tax				253		253
Net income					50,909	50,909
Total comprehensive income						51,166
Stock-based compensation expense			12,177			12,177
Purchase and retirement of common stock	(32)				(736)	(736)
Issuance of common stock under stock-based compensation plans	1,472	1	20,116			20,117
Tax benefit from exercises and cancellations of stock options			3,559			3,559
<b>Balance at December 31, 2010</b>	36,173	36	316,108	281	184,011	500,436
Comprehensive income:						
Change in unrealized gains and losses on available-for-sale securities, net of tax				9		9
Change in unrealized gains and losses on derivatives, net of tax				(267)		(267)

Edgar Filing: NETGEAR, INC - Form 10-K

Net income					91,368	91,368
Total comprehensive income						91,110
Stock-based compensation expense			13,727			13,727
Purchase and retirement of common stock	(25)				(926)	(926)
Issuance of common stock under stock-based compensation plans	1,499	2	30,889			30,891
Tax benefit from exercises and cancellations of stock options			3,519			3,519
<b>Balance at December 31, 2011</b>	37,647	\$ 38	\$ 364,243	\$ 23	\$ 274,453	\$ 638,757

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

**Table of Contents****NETGEAR, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Year Ended December 31,		
	2011	2010	2009
<b>Cash flows from operating activities:</b>			
Net income	\$ 91,368	\$ 50,909	\$ 9,333
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,735	13,439	12,360
Purchase premium amortization (discount accretion) on investments	986	468	(4)
Non-cash stock-based compensation	13,762	12,201	11,024
Income tax benefit associated with stock option exercises and cancellations	3,519	3,559	136
Excess tax benefit from stock-based compensation	(3,672)	(3,470)	(869)
Deferred income taxes	(4,621)	(8,435)	(4,865)
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(34,576)	(63,878)	(24,578)
Inventories	(30,039)	(36,804)	21,650
Prepaid expenses and other assets	(7,935)	(3,220)	103
Accounts payable	28,131	20,074	9,008
Accrued employee compensation	2,765	13,090	3,863
Other accrued liabilities	9,374	21,794	(272)
Deferred revenue	12,555	5,432	598
Income taxes payable	(342)	1,192	10,610
Net cash provided by operating activities	96,010	26,351	48,097
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	(228,871)	(185,128)	(89,827)
Proceeds from sale of short-term investments	227,669	115,000	25,000
Purchase of property and equipment	(8,211)	(8,720)	(3,945)
Loans issued, net of loan repaid		(102)	
Payments for patents		(1,270)	
Cost method investment		(3,009)	
Payments made in connection with business acquisitions	(37,509)	(12,000)	(3,539)
Net cash used in investing activities	(46,922)	(95,229)	(72,311)
<b>Cash flows from financing activities:</b>			
Purchase and retirement of common stock	(926)	(738)	(282)
Proceeds from exercise of stock options	29,139	18,915	1,861
Proceeds from issuance of common stock under employee stock purchase plan	1,752	1,202	1,129
Excess tax benefit from stock-based compensation	3,672	3,470	869
Net cash provided by financing activities	33,637	22,849	3,577
Net increase (decrease) in cash and cash equivalents	82,725	(46,029)	(20,637)
Cash and cash equivalents, at beginning of period	126,173	172,202	192,839
Cash and cash equivalents, at end of period	\$ 208,898	\$ 126,173	\$ 172,202

**Supplemental cash flow information:**

Edgar Filing: NETGEAR, INC - Form 10-K

Cash paid for income taxes	\$ 34,365	\$ 44,083	\$ 14,401
----------------------------	-----------	-----------	-----------

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

**Table of Contents**

**NETGEAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 The Company and Summary of Significant Accounting Policies**

***The Company***

NETGEAR, Inc. ( NETGEAR or the Company ) was incorporated in Delaware in January 1996. The Company is a global networking company that delivers innovative products to consumers, businesses and service providers. For consumers, the Company makes high performance, dependable and easy-to-use home networking, storage and digital media products to connect people with the Internet and their content and devices. For businesses, the Company provides networking, storage and security solutions without the cost and complexity of Big IT. The Company also supplies leading service providers with made-to-order and retail proven, whole home networking solutions for their customers. The Company's products are built on a variety of proven technologies such as wireless, Ethernet and powerline, with a focus on reliability and ease-of-use. The Company sells products primarily through a global sales channel network, which includes traditional retailers, online retailers, wholesale distributors, direct market resellers ( DMRs ), value added resellers ( VARs ), and broadband service providers.

***Basis of presentation***

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in the consolidation of these subsidiaries.

***Fiscal periods***

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.

***Use of estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

***Reclassifications***

In the first quarter of 2011, in order to achieve operational efficiencies, the Company combined its North American, Central American and South American sales forces to form the Americas territory. Previously North America was its own geographic region and the Central American and South American territories were categorized within the Asia Pacific ( APAC ) geographic region. Following this change, the Company is organized into the following three geographic territories: Americas, Europe, Middle-East and Africa ( EMEA ) and APAC. the Company has reclassified its disclosure of net revenue by geography for prior periods to conform to the current period's presentation. The change did not result in material differences from what was previously reported.

***Cash and cash equivalents***

The Company considers all highly liquid investments with an original maturity at the time of purchase of three months or less to be cash equivalents. The Company deposits cash and cash equivalents with high credit quality financial institutions.

## **Table of Contents**

### ***Short-term investments***

Short-term investments are comprised of marketable securities that consist of government securities with an original maturity or a remaining maturity at the time of purchase, of greater than three months and no more than 12 months. All marketable securities are held in the Company's name with one high quality financial institution, which acts as the Company's custodian and investment manager. All of the Company's marketable securities are classified as available-for-sale securities in accordance with the provisions of the authoritative guidance for investments and are carried at fair value with unrealized gains and losses reported as a separate component of stockholders' equity.

### ***Certain risks and uncertainties***

The Company's products are concentrated in the networking industry, which is characterized by rapid technological advances, changes in customer requirements and evolving regulatory requirements and industry standards. The success of the Company depends on management's ability to anticipate and/or to respond quickly and adequately to technological developments in its industry, changes in customer requirements, or changes in regulatory requirements or industry standards. Any significant delays in the development or introduction of products could have a material adverse effect on the Company's business and operating results.

The Company relies on a limited number of third parties to manufacture all of its products. If any of the Company's third-party manufacturers cannot or will not manufacture its products in required volumes, on a cost-effective basis, in a timely manner, or at all, the Company will have to secure additional manufacturing capacity. Any interruption or delay in manufacturing could have a material adverse effect on the Company's business and operating results.

### ***Derivative financial instruments***

The Company uses foreign currency forward contracts to manage the exposures to foreign exchange risk related to expected future cash flows on certain forecasted revenue, costs of revenue, operating expenses, and on certain existing assets and liabilities. Foreign currency forward contracts generally mature within five months of inception. Under its foreign currency risk management strategy, the Company utilizes derivative instruments to reduce the impact of currency exchange rate movements on the Company's operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The company does not use derivative financial instruments for speculative purposes.

The Company accounts for its derivative instruments as either assets or liabilities and records them at fair value. Derivatives that are not defined as hedges in the authoritative guidance for derivatives and hedging must be adjusted to fair value through earnings. For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of cumulative other comprehensive income in stockholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For derivatives designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings.

### ***Concentration of credit risk***

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, short-term investments and accounts receivable. The Company believes that there is minimal credit risk associated with the investment of its cash and cash equivalents and short-term investments, due to the restrictions placed on the type of investment that can be entered into under the Company's investment policy. The Company's short-term investments consist of investment-grade securities, and the Company's cash and investments are held and managed by recognized financial institutions.

---

## **Table of Contents**

The Company's customers are primarily distributors as well as retailers and broadband service providers who sell or distribute the products to a large group of end-users. The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The Company regularly performs credit evaluations of the Company's customers' financial condition and considers factors such as historical experience, credit quality, age of the accounts receivable balances, geographic or country-specific risks and current economic conditions that may affect customers' ability to pay, and, generally, requires no collateral from its customers. The Company secures credit insurance for certain customers in international and domestic markets.

As of December 31, 2011, Best Buy, Inc. represented greater than 10% of the Company's total accounts receivable. As of December 31, 2010, Best Buy, Inc. and Wal-Mart Stores, Inc. each represented greater than 10% of the Company's total accounts receivable.

The Company is exposed to credit loss in the event of nonperformance by counterparties to the foreign currency forward contracts used to mitigate the effect of foreign currency exchange rate changes. The Company believes the counterparties for its outstanding contracts are large, financially sound institutions and thus, the Company does not anticipate nonperformance by these counterparties. However, given the recent, unprecedented turbulence in the financial markets, the failure of additional counterparties is possible.

### ***Fair value measurements***

The carrying amounts of the Company's financial instruments, including cash equivalents, short-term investments, accounts receivable, and accounts payable approximate their fair values due to their short maturities. Foreign currency forward contracts are recorded at fair value based on observable market data. See Note 13, *Fair Value of Financial Instruments*, of the Notes to Consolidated Financial Statements for disclosures regarding fair value measurements in accordance with the authoritative guidance for fair value measurements and disclosures.

### ***Cost method investments and loans receivable***

As of December 31, 2011, the Company has \$3.0 million in cost method investments classified within other non-current assets. The Company measures its cost method investments and loans receivable at fair value quarterly; however, they are recorded at fair value only when an impairment charge is recognized. No impairment charges have been recognized related to the Company's cost method investments and loans receivable in the years ended December 31, 2011 and 2010.

In the second fiscal quarter of 2010, the Company made a \$3.0 million loan to a third party that was classified within prepaid and other current assets. The loan was repaid in the fourth fiscal quarter of 2010. Additionally, the Company made a \$3.0 million cost method investment that was classified within other non-current assets in the fourth fiscal quarter of 2010.

### ***Allowance for doubtful accounts***

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company regularly performs credit evaluations of its customers' financial condition and considers factors such as historical experience, credit quality, age of the accounts receivable balances, and geographic or country-specific risks and economic conditions that may affect a customer's ability to pay. The allowance for doubtful accounts is reviewed quarterly and adjusted if necessary based on the Company's assessments of its customers' ability to pay. If the financial condition of the Company's customers should deteriorate or if actual defaults are higher than the Company's historical experience, additional allowances may be required, which could have an adverse impact on operating expenses.

## **Table of Contents**

### ***Inventories***

Inventories consist primarily of finished goods which are valued at the lower of cost or market, with cost being determined using the first-in, first-out method. The Company writes down its inventories based on estimated excess and obsolete inventories determined primarily by future demand forecasts. At the point of loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

### ***Property and equipment, net***

Property and equipment are stated at historical cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Computer equipment	2 years
Furniture and fixtures	5 years
Software	2-5 years
Machinery and equipment	2-3 years
Leasehold improvements	Shorter of the lease term or 5 years

Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment. Charges related to the impairment of property and equipment were not material in the years ended December 31, 2011, 2010 and 2009.

### ***Goodwill***

The Company performs an annual goodwill impairment test in the fourth quarter of each year. Should certain events or indicators of impairment occur between annual impairment tests, the Company will perform the impairment test as those events or indicators occur. Examples of such events or circumstances include the following: a significant decline in the Company's expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in the business climate; the testing for recoverability of a significant asset group; and slower growth rates. The Company assesses goodwill impairment at the reporting unit level.

In the second fiscal quarter of 2011, the Company performed a goodwill impairment assessment as a result of its change in reportable segments. Refer to Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration*, of the Notes to Consolidated Financial Statements for additional information regarding the change in segment reporting. The company allocated goodwill to each segment based on their relative fair values. The Company then compared the fair value of the new reporting units to the reporting unit's carrying value and determined that goodwill was not impaired since the estimated fair values of each of the reporting units exceeded the carrying values. The fair value of the new business units was determined using an income approach and a market approach which were weighted equally. Under the income approach, the fair value of an asset is based on the value of the estimated cash flows that the asset can be expected to generate in the future. These estimated future cash flows were discounted at rates ranging from 13 to 15 percent to arrive at their respective fair values. Under the market approach, the fair value of the unit is based on an analysis of financial data for publicly traded companies engaged in the same or similar lines of business.

In September 2011, the FASB issued ASU 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. ASU 2011-08 permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount as a basis for



---

**Table of Contents**

determining if performing the two-step goodwill impairment test is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011; however, early adoption is permitted. The Company elected to adopt the updated standard for the purpose of its goodwill impairment testing, and as such performed its annual impairment test of goodwill in the fourth fiscal quarter of 2011. The Company assessed whether it was more likely than not (that is, a likelihood of more than 50%) that each reporting unit's fair value was less than its carrying amount including goodwill by considering the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in the Company's share price. Based on these factors and the recent impairment testing in the second fiscal quarter of 2011, the Company determined that it is not more likely than not that each reporting unit's fair value was less than its carrying amount, and therefore performing the first step of the two-step impairment test for each reporting unit was unnecessary.

No goodwill impairment was recognized in the years ended December 31, 2011, 2010 or 2009.

***Long-lived assets***

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from less than one year to ten years. Purchased intangible assets determined to have indefinite useful lives are not amortized. Long-lived assets, including property and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Such conditions may include an economic downturn or a change in the assessment of future operations. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. If the aggregate undiscounted cash flows are less than the carrying value of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

During the years ended December 31, 2011, 2010 and 2009, there were no events or changes in circumstances that indicated the carrying amount of the Company's long-lived assets may not be recoverable from their undiscounted cash flows. Consequently, the Company did not perform an impairment test or record an impairment of its long-lived assets during those periods.

The Company will continue to evaluate the carrying value of its long-lived assets and if it determines in the future that there is a potential further impairment, the Company may be required to record additional charges to earnings which could affect the Company's financial results.

***Product warranties***

The Company provides for estimated future warranty obligations at the time revenue is recognized. The Company's standard warranty obligation to its direct customers generally provides for a right of return of any product for a full refund in the event that such product is not merchantable or is found to be damaged or defective. At the time revenue is recognized, an estimate of future warranty returns is recorded to reduce revenue in the amount of the expected credit or refund to be provided to its direct customers. At the time the Company records the reduction to revenue related to warranty returns, the Company includes within cost of revenue a write-down to reduce the carrying value of such products to net realizable value. The Company's standard warranty obligation to its end-users provides for replacement of a defective product for one or more years. Factors that affect the warranty obligation include product failure rates, material usage, and service delivery costs incurred in correcting product failures. The estimated cost associated with fulfilling the Company's warranty

**Table of Contents**

obligation to end-users is recorded in cost of revenue. Because the Company's products are manufactured by third-party manufacturers, in certain cases the Company has recourse to the third-party manufacturer for replacement or credit for the defective products. The Company gives consideration to amounts recoverable from its third-party manufacturers in determining its warranty liability. Changes in the Company's warranty liability, which is included as a component of Other accrued liabilities in the consolidated balance sheets, are as follows (in thousands):

	<b>Year Ended December 31,</b>	
	<b>2011</b>	<b>2010</b>
Balance as of beginning of the period	\$ 40,513	\$ 30,610
Provision for warranty liability made during the period	60,285	61,854
Settlements made during the period	(55,952)	(51,951)
Balance at end of period	\$ 44,846	\$ 40,513

**Revenue recognition**

Revenue from product sales is generally recognized at the time the product is shipped provided that persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable and collection of the related receivable is reasonably assured. Currently, for some of the Company's customers, title passes to the customer upon delivery to the port or country of destination, upon their receipt of the product, or upon the customer's resale of the product. At the end of each fiscal quarter, the Company estimates and defers revenue related to product where title has not transferred. The revenue continues to be deferred until such time that title passes to the customer. The Company assesses collectability based on a number of factors, including general economic and market conditions, past transaction history with the customer, and the creditworthiness of the customer. If the Company determines that collection of the fee is not reasonably assured, then the Company defers the fee and recognizes revenue upon receipt of payment.

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). The guidance eliminates the residual method of revenue recognition and allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor-specific objective evidence (VSOE) or third-party evidence (TPE) is unavailable. Concurrently to issuing ASU 2009-13, the FASB also issued ASU No. 2009-14, Certain Revenue Arrangements That Include Software Elements. ASU 2009-14 excludes software that is contained on a tangible product from the scope of software revenue guidance if the software is essential to the tangible product's functionality. The Company elected to early adopt these standards at the beginning of its first quarter of fiscal year 2010 on a prospective basis for applicable transactions originating or materially modified after January 1, 2010.

The Company has an insignificant amount of product offerings with multiple elements. The Company's multiple-element product offerings include networking hardware with embedded software, various software subscription services, and support, which are considered separate units of accounting. In general, the networking hardware with embedded software is delivered up front, while the subscription services and support are delivered over the subscription and support period. The Company allocates revenue to the software deliverables and the non-software deliverables (including software deliverables which function together with hardware deliverables to provide the product's essential functionality) based upon their relative selling price. Revenue allocated to each unit of accounting is then recognized when persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable and collection of the related receivable is reasonably assured.

When applying the relative selling price method, the Company determines the selling price for each deliverable using VSOE of fair value of the deliverable, or when VSOE of fair value unavailable, its best

---

## **Table of Contents**

estimate of selling price ( ESP ), as the Company has determined it is unable to establish TPE of selling price for the deliverables. In determining VSOE, the Company requires that a substantial majority of the selling prices for a deliverable sold on a stand-alone basis fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical stand-alone transactions falling within  $\pm 15\%$  of the median price. The Company determines ESP for a deliverable by considering multiple factors including, but not limited to, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The objective of ESP is to determine the price at which the Company would transact a sale if the deliverable were sold on a stand-alone basis. The determination of ESP is made through consultation with and formal approval by the Company's management, taking into consideration the go-to-market strategy.

The adoption of the new revenue recognition accounting standards did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows for the year ended December 31, 2011 and 2010. The new accounting standards for revenue recognition if applied in the same manner to the year ended December 31, 2009 would not have had a material impact on total net revenues for that fiscal year.

Certain distributors and retailers generally have the right to return product for stock rotation purposes. Upon shipment of the product, the Company reduces revenue for an estimate of potential future product warranty and stock rotation returns related to the current period product revenue. Management analyzes historical returns, channel inventory levels, current economic trends and changes in customer demand for the Company's products when evaluating the adequacy of the allowance for sales returns, namely warranty and stock rotation returns. Revenue on shipments is also reduced for estimated price protection and sales incentives deemed to be contra-revenue under the authoritative guidance for revenue recognition.

### ***Sales incentives***

The Company accrues for sales incentives as a marketing expense if it receives an identifiable benefit in exchange and can reasonably estimate the fair value of the identifiable benefit received; otherwise, it is recorded as a reduction to revenues. As a consequence, the Company records a substantial portion of its channel marketing costs as a reduction of revenue.

The Company records estimated reductions to revenues for sales incentives at the later of when the related revenue is recognized or when the program is offered to the customer or end consumer.

### ***Shipping and handling fees and costs***

The Company includes shipping and handling fees billed to customers in net revenue. Shipping and handling costs associated with inbound freight are included in cost of revenue. In cases where the Company gives a freight allowance to the customer for their own inbound freight costs, such costs are appropriately recorded as a reduction in net revenue. Shipping and handling costs associated with outbound freight are included in sales and marketing expenses and totaled \$13.9 million, \$11.4 million and \$11.0 million in the years ended December 31, 2011, 2010 and 2009 respectively.

### ***Research and development***

Costs incurred in the research and development of new products are charged to expense as incurred.

### ***Technology license arrangements***

The Company expenses the licensing of software technologies intended to be integrated into certain future products if those products have not yet reached technological feasibility and the licensed software does not have alternative future use.

## **Table of Contents**

The Company did not incur any expenses related to technology license arrangements in the years ended December 31, 2011 and 2010.

During the year ended December 31, 2009, the Company entered into a \$2.5 million arrangement to license certain software technologies that the Company may integrate into certain future products. At that time, the Company had not yet established the technological feasibility of these products, and the Company did not believe the software had an alternative future use. As such, the Company expensed the entire technology license arrangement amount of \$2.5 million in the year ended December 31, 2009.

### ***Advertising costs***

Advertising costs are expensed as incurred. Total advertising and promotional expenses were \$21.7 million, \$19.3 million, and \$14.4 million in the years ended December 31, 2011, 2010 and 2009, respectively.

### ***Income taxes***

The Company accounts for income taxes under an asset and liability approach. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences resulting from different treatment for tax versus accounting for certain items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The Company must then assess the likelihood that the Company's deferred tax assets will be recovered from future taxable income and to the extent the Company believes that recovery is not more likely than not, the Company must establish a valuation allowance.

In the ordinary course of business there is inherent uncertainty in assessing the Company's income tax positions. The Company assesses its tax positions and records benefits for all years subject to examination based on management's evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company records the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recorded in the financial statements. Where applicable, associated interest and penalties have also been recognized as a component of income tax expense.

### ***Computation of net income per share***

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options and awards. Potentially dilutive shares are excluded from the computation of diluted net income per share when their effect is anti-dilutive.

### ***Stock-based compensation***

Effective January 1, 2006, the Company adopted the fair value recognition provisions of the updated authoritative guidance for stock compensation, using the modified prospective transition method. Under this transition method, stock-based compensation expense for the year ended December 31, 2009 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of the authoritative guidance for stock compensation. Stock-based compensation expense for all stock-based compensation awards granted on or after January 1, 2006 is based on the grant-date fair value estimated in

---

**Table of Contents**

accordance with the provisions of the updated authoritative guidance for stock compensation. The valuation provisions also apply to grants that are modified after January 1, 2006. The Company recognizes these compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years. The Company will recognize an excess benefit from stock-based compensation in equity based on the difference between tax expense computed with consideration of the windfall deduction and without consideration of the windfall deduction. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit and the foreign tax credit in the income statement. See Note 11, *Employee Benefit Plans*, of the Notes to Consolidated Financial Statements for a further discussion on stock-based compensation.

***Comprehensive income***

Comprehensive income consists of net income and other gains and losses affecting stockholder's equity that the Company excluded from net income, including gains and losses related to fair value of short-term investments and the effective portion of cash flow hedges that were outstanding as of the end of the year.

***Foreign currency translation***

The Company's functional currency is the U.S. dollar for all of its international subsidiaries. Foreign currency transactions of international subsidiaries are re-measured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for non-monetary assets. Expenses are re-measured at average exchange rates in effect during each period, except for expenses related to non-monetary assets, which are re-measured at historical exchange rates. Revenue is re-measured at average exchange rates in effect during each period. Gains and losses arising from foreign currency transactions are included in total comprehensive income and were a net gain of \$131,000 for the year ended December 31, 2011, a net loss of \$130,000 for the year ended December 31, 2010 and a net gain of \$954,000 for the year ended December 31, 2009.

***Recent accounting pronouncements***

In December 2010, the FASB issued ASU 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU 2010-29 specifies that, for material business combinations when comparative financial statements are presented, revenue and earnings of the combined entity should be disclosed as though the business combination had occurred as of the beginning of the comparable prior annual reporting period. ASU 2010-29 also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective prospectively for the Company for business combinations with an acquisition date on or after January 1, 2011. Since the adoption of the update to the authoritative guidance for consolidation only requires additional disclosures, the adoption did not impact the Company's consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, which amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards (IFRS) and provides increased transparency around valuation inputs and investment categorization. ASU 2011-04 is effective prospectively for the Company in the first quarter of fiscal 2012. ASU 2011-04 will only impact the Company's Level 3 disclosures. The adoption is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 allows two presentation alternatives: present items of net income and other comprehensive income (1) in one continuous statement, referred to as the statement of comprehensive income or

**Table of Contents**

(2) in two separate, but consecutive, statements of net income and other comprehensive income. ASU 2011-05 is effective prospectively for the Company in the first quarter of fiscal 2012. In December 2011, the FASB issued ASU 2011-12, which defers the ASU 2011-05 requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The amendments in ASU 2011-12 are effective at the same time as the amendments in Update 2011-05. All other requirements of ASU 2011-05 are not affected by ASU 2011-12. The Company is currently evaluating which presentation alternative it will utilize. Since the adoption of the authoritative guidance only requires additional disclosures, the adoption will not impact the Company's consolidated financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. ASU 2011-08 permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the two-step impairment test for that reporting unit. The Company has elected to early adopt ASU 2011-08 in the fourth quarter of fiscal year 2011. The adoption did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

**Note 2 Business Acquisitions*****Westell Technologies, Inc.***

On April 15, 2011, the Company completed the acquisition of certain intellectual property and other assets of the Customer Networking Solutions division of Westell Technologies, Inc. (Westell) at a purchase price of \$37.0 million in cash. The acquisition included inventories, property and equipment, intangible assets, and liabilities that existed at the closing date, including employee bonuses and product warranties. The acquisition qualifies as a business combination and was accounted for using the acquisition method of accounting. The Company believes the acquisition will bolster its service provider revenue growth and strengthen its market position among U.S. telecommunications operators.

The results of Westell's operations have been included in the consolidated financial statements since the date of acquisition. The historical results of operations of Westell prior to the acquisition were not material to the Company's results of operations.

In accordance with the acquisition method of accounting for business combinations, the Company allocated the total purchase price to identifiable intangible assets based on each element's estimated fair value. Acquisition costs were expensed as incurred, and were immaterial for this transaction. Purchased intangibles will be amortized on a straight-line basis over their respective estimated useful lives. Goodwill was recorded based on the residual purchase price after allocating the purchase price to the fair market value of assets acquired and liabilities assumed. Goodwill arises as a result of, among other factors, future unidentified new products and new technologies as well as the implicit value of future cost savings as a result of the combining of entities. The Company may adjust the preliminary purchase price allocation after obtaining more information regarding, among other things, liabilities assumed, and revisions of preliminary estimates.

The following table summarizes the estimated fair values of the assets and liabilities assumed at the acquisition date (in thousands):

Inventories	\$ 6,290
Property and equipment, net	119
Intangibles, net	19,500
Current liabilities	(646)
Goodwill	11,746
 Total consideration	 \$ 37,009

**Table of Contents**

Of the \$11.7 million of goodwill recorded on the acquisition of Westell, approximately \$10.6 million and \$11.7 million is deductible for U.S. federal and state income tax purposes, respectively.

A total of \$15.7 million of the \$19.5 million in acquired intangible assets was designated as customer contracts and related relationships. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to existing customer contracts and related relationships and discounted at 19.0%. This \$15.7 million is being amortized over its estimated useful life of eight years.

A total of \$3.7 million of the \$19.5 million in acquired intangible assets was designated as core technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the core technology and discounted at 16.0%. This \$3.7 million is being amortized over its estimated useful life of four years.

A total of \$100,000 of the \$19.5 million in acquired intangible assets was designated as order backlog. The value was calculated based on an estimate of order backlog using the expected cash flow for the orders and discounted at 3.3%. This \$100,000 has been fully amortized as of the three months ended October 2, 2011.

**Leaf Networks, LLC**

On January 15, 2010, the Company completed the acquisition of certain intellectual property and other assets of Leaf Networks, LLC ( Leaf ), a developer of virtual networking software. The acquisition qualified as a business acquisition and was accounted for using the purchase method of accounting. The Company believes the acquisition will accelerate the Company's continuing networking technology research and development initiatives. The aggregate purchase price was \$2.1 million, of which \$2.0 million was paid in cash in the first quarter of 2010 and \$100,000 was paid in the three months ended April 3, 2011.

Additionally, the acquisition agreement specified that Leaf shareholders may receive a total additional payout of up to \$900,000 in cash over the three years following the closing of the acquisition if developed products pass certain acceptance criteria. During the first quarter of 2010, the Company determined that the present value of the \$900,000 potential additional payout was approximately \$800,000. For each subsequent quarter, the Company measured at fair value for each reporting period and recorded a liability. The Company paid \$400,000 for the first portion of this additional payout in the three months ended April 3, 2011. As of December 31, 2011, the Company had determined the remaining acceptance criteria for the final \$500,000 portion of the eligible additional payout were nearing completion, and is carrying a liability for the entire \$500,000.

The results of Leaf's operations have been included in the consolidated financial statements since the date of acquisition. The historical results of operations of Leaf prior to the acquisition were not material to the Company's results of operations.

In accordance with the acquisition method of accounting for business combinations, the Company allocated the total purchase price to identifiable intangible assets based on each element's estimated fair value. Acquisition costs were expensed as incurred, and were immaterial for this transaction. Purchased intangibles, representing the existing technology acquired from Leaf, will be amortized on a straight-line basis over their respective estimated useful lives. Goodwill was recorded based on the residual purchase price after allocating the purchase price to the fair market value of intangible assets acquired. Goodwill arose as a result of the \$800,000 present valuation of the \$900,000 potential additional payout, plus \$100,000 in additional payment consideration. The allocation of the purchase price was as follows (in thousands):

Intangibles, net	\$ 2,000
Goodwill	900
<b>Total purchase price allocation</b>	<b>\$ 2,900</b>

**Table of Contents**

Of the \$900,000 of goodwill recorded on the acquisition of Leaf, approximately \$471,000 and \$900,000 was deductible for federal and state income tax purposes, respectively.

The \$2.0 million in acquired intangible assets was designated as existing technology. The value was calculated based on the present value of the future estimated cash flows derived from projections of future revenue attributable to existing technology. This \$2.0 million will be amortized over its estimated useful life of seven years.

***CP Secure International Holding Limited***

On December 18, 2008, the Company completed the acquisition of certain intellectual property and other assets of CP Secure International Holding Limited ( CP Secure ), a privately-held provider of integrated network security solutions. The aggregate purchase price was \$14.0 million, paid in cash. Under the terms of the acquisition agreement, CP Secure shareholders received a total additional payout of \$3.5 million in cash as developed products passed certain acceptance criteria. This additional payout was earned and paid in the year ended December 31, 2009, and was accounted for as additional purchase price and recorded as a \$3.5 million increase to goodwill.

The results of CP Secure s operations have been included in the consolidated financial statements since the date of acquisition. The historical results of operations of CP Secure prior to the acquisition were not material to the Company s results of operations.

The accompanying consolidated financial statements reflect a purchase price of approximately \$14.6 million, consisting of cash, and other costs directly related to the acquisition as follows (in thousands):

Purchase price	\$ 14,000
Direct acquisition costs	635
<b>Total consideration</b>	<b>\$ 14,635</b>

In accordance with the purchase method of accounting, the Company allocated the total purchase price to tangible assets, liabilities and identifiable intangible assets based on their estimated fair values. Purchased intangibles are amortized on a straight-line basis over their respective estimated useful lives. Goodwill was recorded based on the residual purchase price after allocating the purchase price to the fair market value of tangible and intangible assets acquired less liabilities assumed. Goodwill arises as a result of, among other factors, future unidentified new products and new technologies as well as the implicit value of future cost savings as a result of the combining of entities. The allocation of the purchase price in December 2008 was as follows (in thousands):

Inventories	\$ 82
Property and equipment, net	49
Intangibles, net	3,900
Goodwill	10,686
Other accrued liabilities	(82)
<b>Total purchase price allocation</b>	<b>\$ 14,635</b>

Of the \$10.7 million of goodwill recorded on the acquisition of CP Secure, \$5.3 million and \$10.7 million is deductible for federal and state income tax purposes, respectively. Of the \$3.5 million additional payout recorded as goodwill in the year ended December 31, 2009, \$1.7 million and \$3.5 million are deductible for federal and state income tax purposes, respectively.



---

**Table of Contents**

A total of \$1.8 million of the \$3.9 million in acquired intangible assets was designated as in-process research and development. In-process research and development was expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed. The Company acquired two in-process research and development projects, which involve improvements to threat management characteristics of future products. These two projects required further research and development to determine technical feasibility and commercial viability. The fair value assigned to in-process research and development was determined using the income approach, under which the Company considered the importance of products under development to the Company's overall development plans, estimated the costs to develop the purchased in-process research and development into commercially viable products, estimated the resulting net cash flows from the products when completed and discounted the net cash flows to their present values. The Company used a 32% discount rate in the present value calculations, which was derived from a weighted-average cost of capital analysis, adjusted to reflect additional risks related to the products development and success as well as the products' stage of completion. The estimates used in valuing in-process research and development were based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. These assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur. Accordingly, actual results may vary from the projected results. The Company incurred costs of approximately \$1.2 million to complete the projects, of which approximately \$120,000 was incurred during the year ended December 31, 2008 and an additional \$1.1 million was incurred during the year ended December 31, 2009. The Company completed one project in the beginning of the year ended December 31, 2009 and the final project at the end of the year ended December 31, 2009.

A total of \$1.2 million of the \$3.9 million in acquired intangible assets was designated as existing technology. The value was calculated based on the present value of the future estimated cash flows derived from projections of future revenue attributable to existing technology. This \$1.2 million is being amortized over its estimated useful life of three years.

A total of \$900,000 of the \$3.9 million in acquired intangible assets was designated as core technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated royalty savings attributable to the core technology. This \$900,000 is being amortized over its estimated useful life of five years.

***Infrant Technologies, Inc.***

On May 16, 2007, the Company completed the acquisition of 100% of the outstanding shares of Infrant Technologies, Inc. ( Infrant ), a developer of network attached storage products. The aggregate purchase price was \$60 million, paid in cash. Under the terms of the acquisition agreement, Infrant shareholders received a total additional payout of \$20 million in cash over the three years following closure of the acquisition as specific revenue targets were reached. \$10 million was paid in November 2008 and \$10 million was paid in April 2010.

The November 2008 payment of \$10 million resulted in an increase in goodwill of \$8.7 million, the recognition of compensation expense of \$650,000, and a reduction in taxes payable of \$620,000.

The April 2010 payment of \$10 million resulted in an increase in goodwill of \$8.5 million, the recognition of compensation expense of \$677,000, and a reduction in taxes payable of \$869,000. The Company had accrued for \$113,000 of this \$677,000 in compensation expense in the year ended December 31, 2009.

The results of Infrant's operations have been included in the consolidated financial statements since the date of acquisition. The historical results of Infrant prior to the acquisition were not material to the Company's results of operations.

**Table of Contents**

The accompanying consolidated financial statements reflect an initial purchase price of approximately \$60.3 million, consisting of cash, and other costs directly related to the acquisition as follows (in thousands):

Purchase price	\$ 60,000
Direct acquisition costs	254
<b>Total consideration</b>	<b>\$ 60,254</b>

In accordance with the purchase method of accounting, the Company allocated the total purchase price to tangible assets, liabilities and identifiable intangible assets based on their estimated fair values. Goodwill was recorded based on the residual purchase price after allocating the purchase price to the fair market value of tangible and intangible assets acquired less liabilities assumed. Purchased intangibles are amortized on a straight-line basis over their respective estimated useful lives. Goodwill arises as a result of, among other factors, future unidentified new products and new technologies as well as the implicit value of future cost savings as a result of the combining of entities. The total allocation of the purchase price in 2007 was as follows (in thousands):

Cash and cash equivalents	\$ 2,787
Accounts receivable	1,202
Inventories	3,504
Deferred income taxes	667
Prepaid expenses and other current assets	36
Property and equipment	128
Intangibles	22,700
Goodwill	38,185
Accounts payable	(697)
Accrued employee compensation	(396)
Other accrued liabilities	(1,048)
Deferred income tax liability	(6,814)
<b>Total purchase price allocation</b>	<b>\$ 60,254</b>

None of the goodwill recognized related to Infrant is deductible for income tax purposes.

A total of \$4.1 million of the \$22.7 million in acquired intangible assets was designated as in-process research and development. In-process research and development was expensed upon acquisition because technological feasibility has not been established and no future alternative uses exist. The Company acquired three in-process research and development projects. Two projects involve development of new products in the ReadyNAS desktop product category, and one project involves development of a higher end version of a product currently selling in the ReadyNAS rack mount product category. These three projects required further research and development to determine technical feasibility and commercial viability. The fair value assigned to in-process research and development was determined using the income approach, under which the Company considered the importance of products under development to the Company's overall development plans, estimated the costs to develop the purchased in-process research and development into commercially viable products, estimated the resulting net cash flows from the products when completed and discounted the net cash flows to their present values. The Company used discount rates ranging from 36% to 38% in the present value calculations, which was derived from a weighted-average cost of capital analysis, adjusted to reflect additional risks related to the products' development and success as well as the products' stage of completion. The estimates used in valuing in-process research and development were based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. These assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur. Accordingly, actual results may vary from the projected results. The Company incurred costs of approximately \$1.6 million to complete the projects, of which approximately \$1.4 million was incurred during the year ended December 31, 2008 and an additional \$200,000

**Table of Contents**

was incurred during the year ended December 31, 2009. The Company completed two projects in the middle of the year ended December 31, 2008 and the final project in the middle of the year ended December 31, 2009.

A total of \$10.8 million of the \$22.7 million in acquired intangible assets was designated as existing technology. The value was calculated based on the present value of the future estimated cash flows derived from projections of future revenue attributable to existing technology. This \$10.8 million is being amortized over its estimated useful life of four years.

A total of \$5.2 million of the \$22.7 million in acquired intangible assets was designated as core technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated royalty savings attributable to the core technology. This \$5.2 million is being amortized over its estimated useful life of four years.

A total of \$2.6 million of the \$22.7 million in acquired intangible assets was designated as trademarks. The value was calculated based on the present value of the future estimated cash flows derived from estimated royalty savings attributable to use of the trademarks. This \$2.6 million is being amortized over its estimated useful life of six years.

**Note 3 Balance Sheet Components (in thousands)***Available-for-sale short-term*

	As of December 31,							
	2011			Estimated		2010		
	Cost	Unrealized Gain	Unrealized Loss	Fair Value	Cost	Unrealized Gain	Unrealized Loss	Fair Value
U.S. Treasuries	\$ 144,673	\$ 34	\$ (4)	\$ 144,703	\$ 144,551	\$ 17	\$ (4)	\$ 144,564
Certificates of Deposits	94			94				
<b>Total</b>	<b>\$ 144,767</b>	<b>\$ 34</b>	<b>\$ (4)</b>	<b>\$ 144,797</b>	<b>\$ 144,551</b>	<b>\$ 17</b>	<b>\$ (4)</b>	<b>\$ 144,564</b>

*Accounts receivable and related allowances*

	As of December 31,	
	2011	2010
Gross accounts receivable	\$ 279,932	\$ 241,632
Less: Allowance for doubtful accounts	(1,335)	(1,481)
Allowance for sales returns	(13,360)	(10,273)
Allowance for price protection	(3,930)	(3,147)
<b>Total allowances</b>	<b>(18,625)</b>	<b>(14,901)</b>
Accounts receivable, net	\$ 261,307	\$ 226,731

*Inventories*

	As of December 31,	
	2011	2010
Raw materials	\$ 4,676	\$ 1,591
Finished goods	159,048	125,803

Total	\$ 163,724	\$ 127,394
-------	------------	------------

**Table of Contents****Property and equipment, net**

	As of December 31,	
	2011	2010
Computer equipment	\$ 7,109	\$ 6,057
Furniture, fixtures and leasehold improvements	9,757	9,450
Software	19,974	18,553
Machinery and equipment	21,797	17,465
Construction in progress	662	30
	59,299	51,555
Less: Accumulated depreciation and amortization	(43,415)	(34,052)
	\$ 15,884	\$ 17,503

Depreciation and amortization expense pertaining to property and equipment in 2011, 2010 and 2009 was \$9.9 million, \$8.1 million and \$7.3 million, respectively.

**Goodwill**

Activity related to goodwill consisted of the following:

	Old Segment	New Segments			Total
		Retail	Commercial	Service Provider	
Goodwill at December 31, 2009	\$ 64,908	\$	\$	\$	\$ 64,908
Additions related to earn-out payments	8,474				8,474
Net additions related to acquisitions	816				816
Goodwill at December 31, 2010	74,198				74,198
Relative fair value approach	(74,198)	33,546	32,043	8,609	
Goodwill at April 4, 2011		33,546	32,043	8,609	74,198
Net additions related to acquisitions				11,746	11,746
Goodwill at December 31, 2011	\$	\$ 33,546	\$ 32,043	\$ 20,355	\$ 85,944

During 2011, the Company recorded \$11.7 million of goodwill associated with the acquisition of the Customer Networking Solutions division of Westell Technologies, Inc. ( Westell ). During 2010, the Company recorded \$8.5 million of goodwill associated with a \$10 million earn-out payment made in connection with the Company's 2007 acquisition of Infranet. The Company also recorded \$900,000 of goodwill associated with the Company's 2010 acquisition of Leaf, and recorded an \$84,000 reduction in goodwill related to taxes associated with the Company's 2006 acquisition of Skipjam Corp. Refer to Note 2, *Business Acquisitions*, for additional information regarding the Company's acquisitions.

There were no impairments to goodwill in the years ended December 31, 2011, 2010, and 2009. Refer to Note 1, *The Company and Summary of Significant Accounting Policies*, for additional information regarding the Company's goodwill impairment assessment.

**Table of Contents***Intangibles, net*

	December 31, 2010 Cost	December 31, 2010 Net	Additions	Amortization Expense	December 31, 2011 Net	Weighted Average Amortization Period Remaining (Years)
Core technology	\$ 7,100	\$ 973	\$ 3,700	\$ 1,230	\$ 3,443	1.60
Existing technology	14,000	3,038		1,586	1,452	2.54
Trademarks	2,600	1,011		433	578	0.67
Patents	1,270	1,219		128	1,091	4.25
Customer contracts and relationships			15,700	1,308	14,392	3.67
Backlog			100	100		
<b>Total intangible assets</b>	<b>\$ 24,970</b>	<b>\$ 6,241</b>	<b>\$ 19,500</b>	<b>\$ 4,785</b>	<b>\$ 20,956</b>	<b>3.20</b>

	December 31, 2009 Cost	December 31, 2009 Net	Additions	Amortization Expense	December 31, 2010 Net	Weighted Average Amortization Period Remaining (Years)
Core technology	\$ 7,100	\$ 2,453	\$	\$ 1,480	\$ 973	0.92
Existing technology	12,000	4,400	2,000	3,362	3,038	1.86
Trademarks	2,600	1,445		434	1,011	1.17
Patents			1,270	51	1,219	4.75
Non-compete agreements	100					0
<b>Total intangible assets</b>	<b>\$ 21,800</b>	<b>\$ 8,298</b>	<b>\$ 3,270</b>	<b>\$ 5,327</b>	<b>\$ 6,241</b>	<b>2.17</b>

Amortization expense related to intangibles in the years ended December 31, 2011, 2010 and 2009 was \$4.8 million, \$5.3 million and \$5.0 million, respectively. No impairment charges were recorded in the years ended December 31, 2011, 2010 or 2009.

Estimated amortization expense related to intangibles for each of the next five years and thereafter is as follows (in thousands):

Year Ending December 31,	
2012	\$ 3,915
2013	3,626
2014	3,301
2015	2,685
2016	2,377
2017 and thereafter	5,052
<b>Total expected amortization expense</b>	<b>\$ 20,956</b>

**Table of Contents****Other non-current assets**

	As of December 31,	
	2011	2010
Non-current deferred income taxes	\$ 7,977	\$ 7,112
Cost method investment	3,009	3,009
Other	3,371	4,214
Other non-current assets	\$ 14,357	\$ 14,335

**Other accrued liabilities**

	As of December 31,	
	2011	2010
Sales and marketing programs	\$ 44,394	\$ 37,020
Warranty obligation	44,846	40,513
Freight	7,940	7,174
Other	23,300	25,706
Other accrued liabilities	\$ 120,480	\$ 110,413

**Note 4 Restructuring and Other Charges**

The Company accounts for its restructuring plans under the authoritative guidance for exit or disposal activities. The Company presents expenses related to restructuring and other charges as a separate line item in its Consolidated Statements of Operations.

In April 2011, the Company incurred \$1.6 million in restructuring costs for employee severance related to the reorganization into three specific business units. Refer to Note 12, *Segment Information, Operations by Geographic Area and Customer Concentration* for additional information regarding the reorganization into business units. In addition, the Company incurred \$464,000 in transition services in connection with the acquisition of the Customer Networking Solutions division of Westell Technologies, Inc. Refer to Note 2, *Business Acquisitions* for additional information regarding the Westell acquisition.

The following is a summary of the accrued restructuring charges:

	Accrued Restructuring and Other Charges at December 31, 2010		Cash Payments (In thousands)	Accrued Restructuring and Other Charges at December 31, 2011	
		Additions			
Reorganization in business units	\$	\$ 1,630	\$ (1,630)	\$	
Westell acquisition transition costs		464	(464)		
Current portion	\$	\$ 2,094	\$ (2,094)	\$	

In July 2008, the Company ceased using buildings leased in Santa Clara and Fremont, California, and consolidated all personnel and operations from those locations to its new corporate headquarters in San Jose, California. The last of these operating leases expired in December 2010.





**Table of Contents**

The following is a summary of the accrued restructuring charges related to ceasing use of certain buildings:

	Accrued Restructuring Charges at December 31, 2009	Adjustment to Accrual Recognition	Present Value Accretion (In thousands)	Cash Payments	Accrued Restructuring Charges at December 31, 2010
Abandonment of excess leased facilities	\$ 516	\$ (103)	\$ 15	\$ (428)	\$
Current portion	\$ 516				\$
Long-term portion	\$				\$

**Note 5 Derivative Financial Instruments**

The Company's subsidiaries have had and will continue to have material future cash flows, including revenue and expenses, that are denominated in currencies other than the Company's functional currency. The Company and all its subsidiaries designate the U.S. dollar as the functional currency. Changes in exchange rates between the Company's functional currency and other currencies in which the Company transacts will cause fluctuations in cash flow expectations and cash flow realized or settled. Accordingly, the Company uses derivatives to mitigate its business exposure to foreign exchange risk. The Company enters into foreign currency forward contracts in Australian dollars, British pounds, Euros, and Japanese yen to manage the exposures to foreign exchange risk related to expected future cash flows on certain forecasted revenue, costs of revenue, operating expenses, and on certain existing assets and liabilities. The Company does not enter into derivatives transactions for trading or speculative purposes.

**Cash flow hedges**

To help manage the exposure of gross and 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 is 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 hedges portions of its anticipated foreign currency exposure for three to five months. The Company enters into about five forward contracts per quarter with an average size of about \$6 million USD equivalent related to its cash flow hedge program.

The Company expects to reclass to earnings all of the amounts recorded in other comprehensive income associated with its cash flow hedges over the next 12 months. Other comprehensive income associated with cash flow hedges of foreign currency revenue is recognized as a component of net revenue in the same period as the related revenue is recognized. Other comprehensive income associated with cash flow hedges of foreign currency costs of revenue and operating expenses are recognized as a component of cost of revenue and operating expense in the same period as the costs of revenue and operating expenses are recognized, respectively.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur within the designated hedge period or if not recognized within 60 days following the end of the hedge period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the years ended December 31, 2011, 2010, and 2009.

**Table of Contents****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 held on its financial statements to fluctuations in foreign currency exchange rates, as well as to reduce volatility in other income and expense. 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. Foreign currency denominated accounts receivable and payable are hedged with non-designated hedges when the related anticipated foreign revenue and expenses are recognized in the Company's financial statements. The Company also hedges certain non-functional currency monetary assets and liabilities which may not be incorporated into the cash flow hedge program. The Company adjusts its non-designated hedges monthly and enters into about 11 non-designated derivatives per quarter. The average size of its non-designated hedges is about \$2 million USD equivalent and these hedges range from one to five months in duration.

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

The Company's foreign currency forward contracts do not contain any credit-risk-related contingent features. The Company is exposed to credit losses in the event of nonperformance by the counter-parties of its forward contracts. The Company enters into derivative contracts with high-quality financial institutions. In addition, the derivative contracts are limited to a time period of less than six months and the Company continuously evaluates the credit standing of its counter-party financial institutions. The counter-parties to these arrangements are large highly rated financial institutions and the Company does not consider non-performance a material risk.

The fair values of the Company's derivative instruments and the line items on the Consolidated Balance Sheets to which they were recorded as of December 31, 2011 and December 31, 2010 are summarized as follows:

Derivative Assets	Balance Sheet Location	Fair Value at December 31, 2011	Balance Sheet Location	Fair Value at December 31, 2010
(In thousands)				
Derivative assets not designated as hedging instruments	Prepaid expenses and other current assets	\$ 1,196	Prepaid expenses and other current assets	\$ 1,381
Derivative assets designated as hedging instruments	Prepaid expenses and other current assets	41	Prepaid expenses and other current assets	8
<b>Total</b>		<b>\$ 1,237</b>		<b>\$ 1,389</b>

**Table of Contents**

Derivative Liabilities	Balance Sheet Location	Fair Value at December 31, 2011 (In thousands)	Balance Sheet Location	Fair Value at December 31, 2010
Derivative liabilities not designated as hedging instruments	Other accrued liabilities	\$ (654)	Other accrued liabilities	\$ (770)
Derivative liabilities designated as hedging instruments	Other accrued liabilities	(69)	Other accrued liabilities	(19)
<b>Total</b>		<b>\$ (723)</b>		<b>\$ (789)</b>

For details of the Company's fair value measurements, please see Note 13, *Fair Value of Financial Instruments*.

Derivatives Not Designated as Hedging Instruments	Location of Gains or (Losses) Recognized in Income on Derivative	December 31, 2011 Amount of Gains or (Losses) Recognized in Income on Derivative	Year ended December 31, 2010 Amount of Gains or (Losses) Recognized in Income on Derivative (In thousands)
Foreign currency forward contracts	Other income (expense), net	\$ (957)	\$ (172)

The effects of the Company's derivative instruments on other comprehensive income and the Consolidated Statement of Operations for the year ended December 31, 2011 and December 31, 2010 are summarized as follows:

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI-Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income-Effective Portion	Year ended December 31, 2011 Gain or (Loss) Reclassified from OCI into Income-Effective Portion (a) (In thousands)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
<b>Cash flow hedges:</b>					
Foreign currency forward contracts	\$ 542	Net revenue	\$ 967	Other income (expense), net	\$ (310)
Foreign currency forward contracts		Cost of revenue	(4)	Other income (expense), net	
Foreign currency forward contracts		Operating expenses	(154)	Other income (expense), net	
<b>Total</b>	<b>\$ 542</b>		<b>\$ 809</b>		<b>\$ (310)</b>

**Table of Contents**

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI-Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income-Effective Portion	Year ended December 31, 2010		Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
			Gain or (Loss) Reclassified from OCI into Income-Effective Portion (a)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	
<b>Cash flow hedges:</b>					
Foreign currency forward contracts	\$ 2,257	Net revenue	\$ 2,755	Other income (expense), net	\$ (261)
Foreign currency forward contracts		Cost of revenue	(27)	Other income (expense), net	
Foreign currency forward contracts		Operating expenses	(724)	Other income (expense), net	
<b>Total</b>	<b>\$ 2,257</b>		<b>\$ 2,004</b>		<b>\$ (261)</b>

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI-Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income-Effective Portion	Year ended December 31, 2009		Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
			Gain or (Loss) Reclassified from OCI into Income-Effective Portion (a)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	
<b>Cash flow hedges:</b>					
Foreign currency forward contracts	\$ (499)	Net revenue	\$ (707)	Other income (expense), net	\$ (85)
Foreign currency forward contracts		Cost of revenue	15	Other income (expense), net	
Foreign currency forward contracts		Operating expenses	173	Other income (expense), net	
<b>Total</b>	<b>\$ (499)</b>		<b>\$ (519)</b>		<b>\$ (85)</b>

(a) Refer to Note 10, *Stockholders Equity*, which summarizes the activity in other comprehensive income related to derivatives.

The Company did not recognize any net gain or loss related to the ineffective portion of cash flow hedges during the year ended December 31, 2011, 2010 or 2009.

**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 outstanding stock options and unvested restricted stock awards, which are reflected in diluted net income per share by application of the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of stock-based compensation cost for future services that the Company has not yet recognized, and the amount of tax benefit that would be recorded in additional paid-in capital upon exercise are assumed to be used to repurchase shares.

**Table of Contents**

Net income per share for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands, except per share data):

	Year Ended December 31,		
	2011	2010	2009
Net income	\$ 91,368	\$ 50,909	\$ 9,333
Weighted average shares outstanding:			
Basic	37,121	35,385	34,485
Options and awards	811	739	363
Total diluted shares	\$ 37,932	\$ 36,124	\$ 34,848
Basic net income per share	\$ 2.46	\$ 1.44	\$ 0.27
Diluted net income per share	\$ 2.41	\$ 1.41	\$ 0.27

Anti-dilutive common stock options totaling 2,001,300, 3,251,861 and 3,614,698 were excluded from the weighted average shares outstanding for the diluted per share calculation for 2011, 2010 and 2009, respectively.

**Note 7 Other Income (Expense), Net**

Other income (expense), net consisted of the following (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Foreign currency transaction gains (losses), net	\$ 131	(\$ 130)	\$ 954
Foreign currency contract gains (losses), net	(1,267)	(434)	(1,082)
Total	(\$ 1,136)	(\$ 564)	(\$ 128)

**Note 8 Income Taxes**

Income before income taxes consists of the following (in thousands):

	Year Ended December 31,		
	2011	2010	2009
United States	\$ 79,318	\$ 95,291	\$ 38,943
International	44,892	(4,067)	(6,376)
Total	\$ 124,210	\$ 91,224	\$ 32,567

**Table of Contents**

The provision for income taxes consists of the following (in thousands):

	Year Ended December 31,		
	2011	2010	2009
<b>Current:</b>			
U.S. Federal	\$ 27,415	\$ 37,954	\$ 23,718
State	3,319	5,654	2,270
Foreign	6,760	4,947	2,749
	37,494	48,555	28,737
<b>Deferred:</b>			
U.S. Federal	(3,151)	(8,928)	(4,951)
State	(713)	643	(469)
Foreign	(788)	45	(83)
	(4,652)	(8,240)	(5,503)
<b>Total</b>	<b>\$ 32,842</b>	<b>\$ 40,315</b>	<b>\$ 23,234</b>

Net deferred tax assets consist of the following (in thousands):

	Year Ended December 31,	
	2011	2010
<b>Deferred Tax Assets:</b>		
Accruals and allowances	\$ 22,329	\$ 18,453
Net operating loss carryforwards	326	351
Stock-based compensation	6,304	5,982
Deferred rent	2,138	2,313
Deferred revenue	411	286
Tax credit carryforwards	1,433	1,732
Acquired intangible assets	566	
Other	256	593
	33,763	29,710
<b>Deferred Tax Liabilities:</b>		
Acquired intangible assets		(258)
Depreciation and amortization	(2,698)	(2,969)
Unremitted earnings of foreign subsidiaries		(39)
	(2,698)	(3,266)
Net deferred tax assets	31,065	26,444
<b>Current portion</b>	<b>23,088</b>	<b>\$ 19,332</b>
Non-current portion	7,977	7,112
<b>Net deferred tax assets</b>	<b>\$ 31,065</b>	<b>\$ 26,444</b>

## Edgar Filing: NETGEAR, INC - Form 10-K

Management's judgment is required in determining the Company's provision for income taxes, its deferred tax assets and any valuation allowance recorded against its deferred tax assets. In management's judgment it is more likely than not that such assets will be realized in the future as of December 31, 2011, and as such no valuation allowance has been recorded against the Company's deferred tax assets.

**Table of Contents**

The effective tax rate differs from the applicable U.S. statutory federal income tax rate as follows:

	Year Ended December 31,		
	2011	2010	2009
Tax at federal statutory rate	35.0%	35.0%	35.0%
State, net of federal benefit	1.5	4.2	3.1
Impact of international operations	(9.5)	5.1	28.4
Stock-based compensation	0.0	0.7	4.0
Tax credits	(0.7)	(0.7)	(1.7)
Others	0.1	(0.1)	2.5
<b>Provision for income taxes</b>	<b>26.4%</b>	<b>44.2%</b>	<b>71.3%</b>

Income tax benefits in the amount of \$3.5 million, \$3.6 million and \$136,000 related to stock options were credited to additional paid-in capital during the years ended December 31, 2011, 2010 and 2009, respectively. As a result of changes in fair value of available for sale securities, income tax expense of \$8,000, \$3,000 and \$40,000 was recorded in comprehensive income related to the year ended December 31, 2011, December 31, 2010, and December 31, 2009, respectively.

As of December 31, 2011, the Company has \$574,000 and \$1.4 million of acquired federal and state net operating loss carry forwards as well as \$310,000 of California tax credits carryforwards. All of these losses and \$111,000 of these credits are subject to annual usage limitations under Internal Revenue Code Section 382. The federal losses expire in different years beginning in fiscal 2021. The state loss begins to expire in fiscal 2015. The state tax credit carryforward has no expiration.

The Company files income tax returns in the U.S. federal jurisdiction, various state and local, and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examinations for years before 2007. In 2011, the IRS commenced an examination of the Company's 2008 and 2009 tax years. The Company has limited audit activity in various states 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 12 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 resulting from the expiration of statutes of limitation in multiple jurisdictions in the next 12 months is approximately \$1.0 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.



**Table of Contents**

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits ( UTB ) is as follows (in thousands):

	<b>Federal, State, and Foreign Tax</b>
<b>Gross UTB Balance at January 1, 2009</b>	<b>\$ 13,291</b>
Additions based on tax positions related to the current year	3,608
Additions for tax positions of prior years	184
Reductions for tax positions of prior years	(1)
Reductions due to lapse of applicable statutes	(581)
<b>Gross UTB Balance at December 31, 2009</b>	<b>16,501</b>
Additions based on tax positions related to the current year	3,371
Additions for tax positions of prior years	409
Settlements	(47)
Reductions for tax positions of prior years	(1,805)
Reductions due to lapse of applicable statutes	3
<b>Gross UTB Balance at December 31, 2010</b>	<b>18,432</b>
Additions based on tax positions related to the current year	1,795
Additions for tax positions of prior years	1,015
Settlements	(179)
Reductions for tax positions of prior years	(2)
Reductions due to lapse of applicable statutes	(3,699)
Adjustments due to foreign exchange rate movement	(27)
<b>Gross UTB Balance at December 31, 2011</b>	<b>\$ 17,335</b>

The total amount of net unrecognized tax benefits that, if recognized would affect the effective tax rate as of December 31, 2011 is \$15.5 million. The ending net UTB results from adjusting the gross balance at December 31, 2011 for items such as U.S. federal and state deferred tax, foreign tax credits, interest, and deductible taxes. The net UTB is included as a component of non-current income taxes payable within the consolidated balance sheet.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the years ended December 31, 2011, December 31, 2010 and December 31, 2009, total interest and penalties expensed were \$30,000, \$262,000 and \$354,000, respectively. As of December 31, 2011 and December 31, 2010, accrued interest and penalties on a gross basis was \$1.9 million and \$1.8 million, respectively. Included in accrued interest are amounts related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest, the impact of any uncertain tax benefits related to temporary differences would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

With the exception of those foreign sales subsidiaries for which deferred tax has been provided, the Company intends to indefinitely reinvest foreign earnings. These earnings were approximately \$40.2 million and \$10.1 million as of December 31, 2011 and December 31, 2010, respectively. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the income tax liability that would be payable if such earnings were not indefinitely reinvested.

**Table of Contents****Note 9 Commitments and Contingencies****Leases**

The Company leases office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense in the years ended, December 31, 2011, 2010 and 2009 was \$7.0 million, \$6.4 million and \$6.2 million, respectively. The terms of some of the Company's office leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

Future minimum lease payments under non-cancelable operating leases are as follows (in thousands):

<b>Year Ending December 31,</b>	
2012	\$ 6,349
2013	5,268
2014	4,486
2015	3,981
2016	3,558
Thereafter	6,070
<b>Total minimum lease payments</b>	<b>\$ 29,712</b>

**Employment Agreements**

The Company has signed various employment agreements with key executives pursuant to which, if their employment is terminated without cause, such employees are entitled to receive their base salary (and commission or bonus, as applicable) for 52 weeks (for the Chief Executive Officer), 39 weeks (for the Senior Vice President of Worldwide Operations and Support) and up to 26 weeks (for other key executives). Such employees will also continue to have stock options vest for up to a one-year period following such termination without cause. If a termination without cause or resignation for good reason occurs within one year of a change in control, such employees are entitled to full acceleration (for the Chief Executive Officer) and up to two years acceleration (for other key executives) of any unvested portion of his or her stock options.

**Purchase Obligations**

The Company has entered into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. At December 31, 2011, the Company had \$139.4 million in non-cancelable purchase commitments with suppliers. The Company establishes a loss liability for all products it does not expect to sell for which it has committed purchases from suppliers. Such losses have not been material to date.

**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 limits its exposure and 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 these indemnification agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2011.

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights

**Table of Contents**

of third parties. The terms of these indemnification agreements are generally perpetual any time after execution of the agreement. The maximum amount of potential future indemnification is unlimited. The Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2011.

***Litigation and Other Legal Matters******Wi-Lan Inc. v. NETGEAR***

In October 2007, a lawsuit was filed against the Company by Wi-Lan Inc. ( Wi-Lan ), a patent-holding company existing under the laws of Canada, in the U.S. District Court, Eastern District of Texas. Wi-Lan alleged that the Company infringed U.S. Patent Nos. 5,282,222, RE37,802 and 5,956,323. Wi-Lan accused the Company of infringement with respect to its wireless networking products compliant with the IEEE 802.11 standards and ADSL products compliant with the ITUG.992 standards. Wi-Lan also sued 21 other technology companies alleging similar claims of patent infringement. The Company filed its answer to the lawsuit in the first quarter of 2008. A claim construction hearing took place for the 222 and 802 Patents on March 11, 2010, and on May 11, 2010, the Court issued its order interpreting the claims of these patents (claim construction order). The claim construction hearing on the 323 patent occurred on September 1, 2010, and the Court subsequently issued its claim construction order for this patent. The Court ordered that infringement of the RE37,802 and 5,282,222 (Wi-Fi) patents would be tried first, as to all defendants, and infringement of the 5,956,323 (DSL) patent would be addressed in a second trial. Shortly before the beginning of the first trial, the Company and Wi-Lan entered into settlement discussions. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company and Wi-Lan signed a binding release agreement in which the Company agreed to make a one-time lump sum payment to be paid by May 15, 2011 in consideration for mutual general releases. In the agreement, each party agreed to release the other party from all claims, known or unknown, under any of the 222, 802 and 323 Patents with respect to the manufacture, use, sale, etc. of products by the Company. Each party agreed to bear its own costs and attorneys' fees. The Company made the required one-time lump sum payment that was due by May 15, 2011. This arrangement is not expected to have a material impact on the Company's consolidated financial position, results of operations, or cash flows. The Court has dismissed all claims between Wi-Lan and the Company, including all claims presented by Wi-Lan's complaint and all of the Company's counterclaims, and neither of the scheduled trials between Wi-Lan and the Company will occur. This litigation matter is now concluded.

***Fujitsu et. al v. NETGEAR***

In December 2007, a lawsuit was filed against the Company by Fujitsu Limited, LG Electronics, Inc. and U.S. Philips Corporation in the U.S. District Court, Western District of Wisconsin. The plaintiffs allege that the Company infringes U.S. Patent Nos. 6,018,642, 6,469,993 and 4,975,952. The plaintiffs accuse the Company's wireless networking products compliant with the IEEE 802.11 standards of infringement. The Company filed its answer to the lawsuit in the first quarter of 2008. The District Court held a claim construction hearing on August 15, 2008. On September 10, 2008, the District Court issued a claim construction order. In February 2009, the parties filed numerous motions for summary judgment concerning, among other things, non-infringement, invalidity, and other affirmative defenses. In September 2009, the District Court granted the Company's motion for summary judgment of non-infringement of the three patents-in-suit. The District Court determined that the Company's compliance with the 802.11 standard did not necessarily infringe the patents-in-suit and that the plaintiffs did not provide adequate evidence regarding the function of the Company's products to put the issue of infringement before a jury. In light of the District Court's determination that the patents-in-suit were not infringed, the District Court declined to address the Company's summary judgment claims of the invalidity of the patents in question. On December 23, 2009, the Plaintiffs filed two briefs with the Federal Circuit appealing the District Court's summary judgment rulings. On December 30, 2009, the District Court ordered litigation costs in the amount \$175,000 to be reimbursed to the Company, which were never collected or recognized. The Company's opposition brief to the Plaintiff's appeal was submitted on February 18, 2010. The Federal Circuit heard oral arguments on the Plaintiffs' appeal on June 7, 2010. On September 20, 2010, the Federal Circuit

---

**Table of Contents**

issued a unanimous ruling that made three separate findings. It affirmed a summary judgment ruling from the District Court that the Company did not infringe the claims of a Fujitsu patent related to wireless communications technology. In addition, the Court affirmed a summary judgment ruling that the Company did not infringe the claims of an LG Electronics Inc. patent also related to wireless communications technology. Further, the court affirmed the lower court's ruling that the Company did not infringe a Philips patent for a method of transmitting data messages in a communications network, except for four products. For those four products, the Court ruled that Philips produced sufficient evidence of direct infringement, so that an infringement trial for these four products could proceed. On October 19, 2010, plaintiff LG Electronics submitted a petition for rehearing to the Federal Circuit requesting that the Federal Circuit's decision be set aside with respect to LG Electronics' asserted patent and that a rehearing be granted. The Federal Circuit denied LG Electronics' petition for a rehearing on November 2, 2010, letting stand its September 20, 2010 order affirming the District Court's decision to grant the Company summary judgment of noninfringement on the patent asserted by LG Electronics. Subsequent to the Federal Circuit ruling, the parties began settlement discussions with respect to the four remaining products accused of infringing the Philips patent. On March 8, 2011, the District Court approved the settlement agreement between Philips and the Company. This arrangement is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows. This litigation matter is now concluded.

*OptimumPath, L.L.C. v. NETGEAR*

In January 2008, a lawsuit was filed against the Company by OptimumPath, L.L.C. ( OptimumPath ), a patent-holding company existing under the laws of the State of South Carolina, in the U.S. District Court, District of South Carolina. OptimumPath claims that certain of the Company's wireless networking products infringe on OptimumPath's U.S. Patent No. 7,035,281. OptimumPath also sued six other technology companies alleging similar claims of patent infringement. The Company filed its answer to the lawsuit in the second quarter of 2008. Several defendants, including the Company, jointly filed a request for *inter partes* reexamination of the OptimumPath patent with the United States Patent and Trademark Office (the USPTO) on October 13, 2008. On January 12, 2009, a reexamination was ordered with respect to claims 1-3 and 8-10 of the patent, but denied with respect to claims 4-7 and 11-32 of the patent. On February 4, 2009, the defendants jointly filed a petition to challenge the denial of reexamination of claims 4-7 and 11-32. In March 2009, the District Court granted defendants' motion to transfer the case to the U.S. District Court, Northern District of California. In July 2009, the petition to challenge the denial of reexamination of claims 4-7 and 11-32 was denied. The Company and OptimumPath attended a Court-ordered mediation on September 22, 2009 but were unable to make progress towards settlement. The Company and other defendants filed a combined claim construction/summary judgment brief on December 23, 2010. OptimumPath responded on January 20, 2011, and the defendants replied on February 3, 2011. The oral arguments on claim construction and the summary judgment motion were made on February 17, 2011. On April 12, 2011, the District Court granted defendants' motion for summary judgment on OptimumPath's claim for literal infringement and defendants' motion to preclude OptimumPath's infringement claims based on the doctrine of equivalents. The Court also found that the accused devices did not infringe under the doctrine of equivalents. The Court also granted defendants' motion for summary judgment that asserted claims 1, 2, 6, and 9 through 13 of the 281 patent were invalidated by various prior art. The pretrial conference and trial dates were vacated. OptimumPath filed its notice of appeal to the Federal Circuit of the District Court's rulings on May 18, 2011. On May 23, 2011, the District Court entered the defendants' joint request for costs in the amount of \$102,554.00, which have not yet been collected or recognized. On June 29, 2011, the Federal Circuit docketed the appeal. OptimumPath submitted its opening brief in its appeal to the Federal Circuit on October 21, 2011, the defendants' answering brief was submitted on December 2, 2011, and OptimumPath's reply brief was submitted on December 16, 2011. The next step is the oral argument on the briefing before the Court of Appeals for the Federal Circuit, scheduled for March 5, 2012.

*Ruckus Wireless v. NETGEAR*

In May 2008, a lawsuit was filed against the Company by Ruckus Wireless ( Ruckus ), a developer of Wi-Fi technology, in the U.S. District Court, Northern District of California. Ruckus alleges that the Company

---

**Table of Contents**

infringes U.S. Patent Nos. 7,358,912 ( 912 Patent) and 7,193,562 ( 562 Patent) in the course of deploying Wi-Fi antenna array technology in its WPN824 RangeMax wireless router. Ruckus also sued Rayspan Corporation alleging similar claims of patent infringement. The Company filed its answer to the lawsuit in the third quarter of 2008. The Company and Rayspan Corporation jointly filed a request for *inter partes* reexamination of the Ruckus patents with the USPTO on September 4, 2008. The Court issued a stay of the litigation while the reexaminations proceeded in the USPTO. On November 28, 2008, a reexamination was ordered with respect to claims 11-17 of the 562 Patent, but denied with respect to claims 1-10 and 18-36. On December 17, 2008, the defendants jointly filed a petition to challenge the denial of reexamination of claims 1-10 and 18-36 of the 562 Patent. In July 2009, the petition was denied, and the remaining claims 11-17 were confirmed. The Company is appealing the confirmation of claims 11-17. On December 2, 2008, reexamination was granted with regard to the 912 Patent. In early October 2009, the Company received an Action Closing Prosecution in the reexamination of the 912 Patent. All the claims of the 912 Patent, with the exception of the unchallenged claims 7 and 8, were finally rejected by the USPTO. On October 30, 2009, Ruckus submitted an after-final amendment in the 912 Patent reexamination proceeding. The Company's comments to Ruckus' after-final amendment were submitted on November 30, 2009. On December 1, 2009, the Court found that bifurcating the 562 Patent from the 912 Patent and commencing litigation on the 562 Patent while the USPTO reexamination process and appeals are still pending would be an inefficient use of the Court's resources. Accordingly, the Court ruled that the litigation stay should remain in effect. On September 12, 2010, the Company filed the rebuttal brief in its appeals of the USPTO's rulings during the reexamination of the 562 Patent, and the Company requested an oral hearing with the Board of Appeals at the USPTO to discuss this brief. On September 13, 2010, Ruckus filed a notice of appeal of the 912 Patent to appeal the adverse rulings it received from the USPTO in the reexamination of this patent. The Company filed a respondent's brief in the 912 Patent case on January 24, 2011. An oral hearing in the 562 case was set for February 1, 2011, but the Company decided to cancel it and let the USPTO decide the 562 case based solely on the previously submitted papers. On May 13, 2011, the USPTO indicated that the Company was successful in its appeal of the examiner's previous decision to allow claims 11-17 in the 562 reexamination, and the USPTO Board of Appeals reversed the examiner's decision and declared those claims invalid. On June 13, 2011, Ruckus submitted a request for rehearing by the Board of Appeals of its decision to reject claims 11-17 of the 562 Patent. On September 28, 2011, the Board of Patent Appeals and Interferences denied Ruckus's request for a rehearing in the 562 Patent reexamination case. Ruckus did not timely file a notice of appeal to the Court of Appeals for the Federal Circuit appealing the USPTO's cancellation of claims 11-17 of the 562 patent. Therefore, a reexamination certificate will issue with claims 11-17 cancelled and claims 1-10 and 18-36 confirmed.

On November 4, 2009, Ruckus filed a new complaint in the U.S. District Court, Northern District of California alleging the Company and Rayspan Corporation infringe a patent that is related to the patents previously asserted against the Company and Rayspan Corporation by Ruckus, as discussed above. This newly asserted patent is U.S. Patent No. 7,525,486 entitled "Increased wireless coverage patterns." As with the previous Ruckus action, the WPN824 RangeMax wireless router is the alleged infringing device. The Company challenged the sufficiency of Ruckus's complaint in this new action and moved to dismiss the complaint. Ruckus opposed this motion. The Court partially agreed with the Company's motion and ordered Ruckus to submit a new complaint, which Ruckus did. The initial case management conference occurred on February 11, 2010. On March 25, 2010, the Court ordered a stay until the completion of the 562 Patent's reexamination proceedings in the first Ruckus lawsuit against the Company and Rayspan. The Court instructed the parties to submit status reports to the Court every six months, apprising the Court of the status of the pending reexamination proceedings in the USPTO. Upon final exhaustion of all pending reexamination proceedings of the 562 Patent, including any appeals, the Court ordered the parties to jointly submit to the Court a letter indicating that all appeals have been exhausted and requesting a further case management conference. The case remains stayed.

On November 19, 2010, the Company filed suit against Ruckus in the U.S. District Court, District of Delaware for infringement of four of the Company's patents. The Company alleges that Ruckus's manufacture, use, sale or offers for sale within the United States or importation into the United States of products, including wireless communication products, infringe United States Patent Nos. 5,812,531, 6,621,454, 7,263,143, and

---

**Table of Contents**

5,507,035, all owned by the Company. The Company granted Ruckus an extension to file its answer to the Company's suit, and on January 11, 2011, Ruckus filed a motion to dismiss the Company's suit based on insufficient pleadings. The Company filed its response to Ruckus's motion on January 31, 2011. In addition, on May 6, 2011, Ruckus filed a motion to transfer venue to the Northern District of California. The Court denied Ruckus's motion to transfer the case to the Northern District of California and granted the Company leave to file an amended complaint rather than address the Ruckus motion to dismiss based on insufficient pleadings. The Company filed the proposed amended complaint. Nevertheless, Ruckus filed a second motion to dismiss based on insufficient pleadings by the Company. The Company has filed its opposition to Ruckus's motion, and the Court has not yet ruled on the motion.

*Northpeak Wireless, LLC v. NETGEAR*

In October 2008, a lawsuit was filed against the Company and 30 other companies by Northpeak Wireless, LLC (Northpeak) in the U.S. District Court, Northern District of Alabama. Northpeak alleges that the Company's 802.11b compatible products infringe certain claims of U.S. Patent Nos. 4,977,577 and 5,987,058. The Company filed its answer to the lawsuit in the fourth quarter of 2008. On January 21, 2009, the District Court granted a motion to transfer the case to the U.S. District Court, Northern District of California. In August 2009, the parties stipulated to a litigation stay pending a reexamination request to the USPTO on the asserted patents. The reexaminations of the patents are proceeding. In March 2011, the USPTO confirmed the validity of the asserted claims of the 577 patent over certain prior art references. In April 2011, the USPTO issued a final office action rejecting both asserted claims of the 058 patent as being obvious in light of the prior art. The case remains stayed by stipulation, and no trial date has been set.

*WIAV Networks, LLC v. NETGEAR*

In July 2009, a lawsuit was filed against the Company and over 50 other companies by WIAV Networks, LLC (WIAV) in the U.S. District Court, Eastern District of Texas. WIAV alleges that the Company and the other defendants infringe U.S. Patent Nos. 6,480,497 and 5,400,338. WIAV alleges that the Company's wireless networking devices, including various routers and gateways, infringe upon WIAV's patents. The Company filed its answer to the lawsuit in October 2009 and asserted that WIAV's patents were both invalid and not infringed upon by the Company. In March 2010, the Company and its co-defendants filed a motion to transfer the case to the U.S. District Court, Northern District of California. WIAV opposed the motion. On June 3, 2010, the Court heard the defendants' motion to transfer the case from the Eastern District of Texas to the Northern District of California. The Court took the motion under consideration, and on July 15, 2010, the Court ruled that it would transfer the case to the U.S. District Court, Northern District of California. Discovery has not commenced. On August 31, 2010, the U.S. District Court, Northern District of California ordered WIAV to demonstrate why the Court should not dismiss all but the first named defendant from the lawsuit. The parties briefed and argued this issue before the Court. In response, the Court dismissed without prejudice all the defendants from the case except Hewlett-Packard Company.

*PACid Group, LLC v. NETGEAR*

In July 2009, a lawsuit was filed against the Company and 30 other companies by The PACid Group, LLC (PACid) in the U.S. District Court, Eastern District of Texas. PACid alleges that the Company and the other defendants infringe U.S. Patent Nos. 5,963,646 (646 Patent) and 6,049,612 (612 Patent). PACid alleges that certain unnamed NETGEAR products that use encryption methods infringe upon PACid's patents. The Company filed its answer to the lawsuit in September 2009 and asserted that PACid's patents were both invalid and not infringed by the Company. Discovery has not yet commenced. Most of the Company's chipset suppliers have settled out of the lawsuit and obtained a license to the plaintiff's asserted patents. Because most of the accused infringement occurred in the chipset, this settlement by the chipset suppliers limits the claims the plaintiff has against the Company. On March 7, 2011, the Company attended a status conference. On May 17, 2011, the Court held another status conference. At this conference, the Company indicated to the Court that a small percentage of

**Table of Contents**

the relevant products have non-licensed chip sets. The Court ordered that within 21 days of the status conference PACid shall produce all license agreements it has entered into; within 30 days of the status conference, all defendants shall produce a declaration on sales data; and within 14 days from that defendant production, PACid shall dismiss without prejudice the appropriate defendants. The parties complied with the order, and PACid did not dismiss the Company. On August 23, 2011, at mediation between the Company and PACid, a settlement of this lawsuit was reached. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company and PACid signed a binding release agreement in which the Company agreed to make a one-time lump sum payment in consideration for mutual general releases. In the agreement, each party agreed to release the other party from all claims, known or unknown, under any of the 646 and 612 Patents with respect to the manufacture, use, sale, etc. of products by the Company. Each party agreed to bear its own costs and attorneys' fees. The Company has made the required one-time lump sum payment. This arrangement is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows. The Court has dismissed all claims between PACid and the Company, including all claims presented by PACid's complaint and all of the Company's counterclaims, and the trial in this matter will not occur. This litigation matter is now concluded.

*MPH Technologies Oy v. NETGEAR*

On February 4, 2010, the Company was sued by MPH Technologies Oy ( MPH ) for infringement of U.S. patent 7,346,926 entitled Method for Sending Messages Over Secure Mobile Communication Links. MPH alleges that the Company's VPN Client Software, Dual WAN gigabit SSL VPN Firewall, ProSafe Dual WAN VPN Firewall with 8-port 10/100 Switch, ProSafe VPN Firewall with 8-port 10/100 Switch, ProSafe VPN Firewall 8 with 8-Port 10/100 Switch, ProSafe VPN Firewall 8 with 4-Port 10/100 Mbps Switch, ProSafe 802.11g Wireless ADSL Modem VPN Firewall Router, ProSafe Wireless-N VPN Firewall, and ProSafe 802.11 wireless VPN Firewall 8 with 8-port 10/100 Mbps Switch infringe claims of the 926 Patent. On May 17, 2010, the defendants jointly filed a motion to transfer the case to the U.S. District Court, Northern District of California. In addition, the Company filed its answer, affirmative defenses, and counterclaims on that day. On June 9, 2010, the plaintiff filed its answer to the Company's invalidity counterclaim and its response to the defendants' motion to transfer. On June 23, 2010, the defendants filed their joint reply to plaintiff's response to the defendants' motion to transfer venue. On July 16, 2010, the Court issued an order transferring the case to the Northern District of California. On September 10, 2010, the Company amended its answer to the complaint. The initial scheduling conference occurred on December 2, 2010. In response to this conference, the Court ordered that the Plaintiff must file its opening claim construction brief no later than May 17, 2011 and that defendants must file their responsive claim construction briefs no later than May 31, 2011. The Court also ordered that a claim construction hearing take place on June 22, 2011. The Company and plaintiff signed a settlement agreement on May 15, 2011. In the agreement, the Company agreed to pay a one-time lump sum payment and grant MPH certain other patent rights in return for each party agreeing to release the other party from all claims, known or unknown, under the patent in suit and related patents with respect to the manufacture, use, sale, etc. of products by the Company. The Company received a fully paid, worldwide, perpetual license to the patent in suit and all foreign counterparts and related patents. This arrangement is not expected to have a material impact on the Company's consolidated financial position, results of operations, or cash flows. On May 16, 2011, the Court dismissed the case with prejudice, with each party to bear its own attorneys' fees and costs. The Company has since made the lump sum payment to MPH, and this litigation matter is now concluded.

*Ericsson v. NETGEAR*

On September 14, 2010, Ericsson Inc. and Telefonaktiebolaget LM Ericsson filed a patent infringement lawsuit against the Company and defendants D-Link Corporation, D-Link Systems, Inc., Acer, Inc., Acer America Corporation, and Gateway, Inc. in the U.S. District Court, Eastern District of Texas alleging that the defendants infringe certain Ericsson patents. The Company has been accused of infringing eight U.S. patents: 5,790,516; 6,330,435; 6,424,625; 6,519,223; 6,772,215; 5,987,019; 6,466,568; and 5,771,468. Ericsson generally

**Table of Contents**

alleges that the Company and the other defendants have infringed and continue to infringe the Ericsson patents through the defendants' IEEE 802.11-compliant products. In addition, Ericsson alleges that the Company has infringed, and continues to infringe, the claimed methods and apparatuses of the '468 Patent through the Company's PCMCIA routers. The Company filed its answer to the Ericsson complaint on December 17, 2010 where it asserted the affirmative defenses of noninfringement and invalidity of the asserted patents. On March 1, 2011, the defendants filed a motion to transfer venue to the District Court for the Northern District of California and their memorandum of law in support thereof. On March 21, 2011, Ericsson filed its opposition to the motion, and on April 1, 2011, defendants filed their reply to Ericsson's opposition to the motion to transfer. On June 8, 2011, Ericsson filed an amended complaint that added Dell, Toshiba and Belkin as defendants. At the status conference held on June 9, 2011, the Court set a Markman hearing for June 28, 2012 and trial for June 3, 2013. On June 14, 2011, Ericsson submitted its infringement contentions against the Company. On September 29, 2011, the Court denied the defendants motion to transfer venue to the Northern District of California. Discovery is ongoing. The parties are now approaching the Markman hearing, and the schedule is as follows: March 9, 2012 exchange of proposed constructions of claim terms; April 9, 2012 Joint Claim Construction Statement filing deadline; May 4, 2012 Ericsson's Markman brief; May 16, 2012 Tutorials due; June 1, 2012 Defendants Markman brief; June 15 Ericsson's Reply Markman brief; and June 28, 2012 Markman hearing.

*Fujitsu v. NETGEAR*

On September 3, 2010, Fujitsu filed a complaint against the Company, Belkin International, Inc., Belkin, Inc., D-Link Corporation, D-Link Systems, Inc., ZyXEL Communications Corporation, and Zyxel Communications, Inc in the U.S. District Court, Northern District of California alleging that certain of the Company's products infringe upon Fujitsu's U.S. patent Re. 36,769 patent ('769 Patent) through various cards and interface devices within the Company's products. The Company answered the complaint denying the allegations of infringement and claiming that the asserted patent is invalid. In addition, the Company filed a motion to disqualify counsel for Fujitsu. The Company's disqualification motion was argued before the Court on December 16, 2010, and on December 22, 2010, the Court granted the Company's motion and disqualified counsel for Fujitsu. In response, Fujitsu requested a stipulation from all parties to reset the case management conference and scheduled hearing dates for the motions to dismiss. The initial case management conference was held on March 18, 2011. A claim construction hearing was held on October 14, 2011. On February 3, 2012, the Court issued its claim construction order based on the claim construction hearing. The parties are currently participating in the discovery process. Expert reports and accompanying discovery opens May 4, 2012 and closes June 8, 2012. Dispositive motions are due June 28, 2012, and trial is set to commence on November 26, 2012.

*Data Network Storage, LLC v. NETGEAR*

In April 2009, a lawsuit was filed against the Company and 14 other companies by Data Network Storage, LLC ('DNS') in the U.S. District Court for the Southern District of California. DNS alleges that the Company and the other third parties infringe U.S. Patent No. 6,098,128. In particular, DNS is alleging that several of the Company's ReadyNAS products infringe upon DNS's patents. The Company filed its answer to the lawsuit in July 2009 and asserted that DNS's patents were both invalid and had not been infringed upon by the Company. In September 2009, at a Court-sanctioned early neutral evaluation, the parties were unable to reach an agreement on a settlement, and discovery continued. On January 27, 2010, the Court denied co-defendant Fujitsu America, Inc.'s motion to stay the litigation, and the Company submitted its invalidity contentions on February 1, 2010. The Company and the plaintiff entered into settlement discussions in early March. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company agreed to make a one-time lump sum payment in consideration for a fully paid and perpetual license to, and a covenant not to sue on, the '128 patent and the plaintiff's entire portfolio of U.S. patents, related patents, and foreign counterparts. The Company has made the required one-time lump sum payment, and the lawsuit by DNS against the Company was dismissed with prejudice on April 23, 2010. This arrangement did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows for the year ended December 31, 2010.



**Table of Contents***NETGEAR v. CSIRO*

In May 2005, the Company filed a complaint for declaratory relief against the Commonwealth Scientific and Industrial Research Organization (CSIRO), in the San Jose division of the United States District Court, Northern District of California. The complaint alleged that the claims of CSIRO's U.S. Patent No. 5,487,069 are invalid and not infringed by any of Company's products. CSIRO had asserted that the Company's wireless networking products implementing the IEEE 802.11a, 802.11g, and 802.11n wireless LAN standards infringe this patent. In July 2006, the United States Court of Appeals for the Federal Circuit affirmed the District Court's decision to deny CSIRO's motion to dismiss the action under the Foreign Sovereign Immunities Act. In September 2006, the Federal Circuit denied CSIRO's request for a rehearing *en banc*. CSIRO filed a response to the complaint in September 2006. In December 2006, the District Court granted CSIRO's motion to transfer the case to the Eastern District of Texas, where CSIRO had brought and won a similar lawsuit against Buffalo Technology (USA), Inc., which Buffalo appealed and which was partially remanded to the District Court. The District Court consolidated this action with three related actions involving other companies (such as Buffalo) accused of infringing CSIRO's patent. The Company attended a Court-mandated mediation in November 2007 but failed to resolve the litigation. The District Court held a June 26, 2008 claim construction hearing. On August 14, 2008, the District Court issued a claim construction order and denied a motion for summary judgment of invalidity. In December 2008, the parties filed numerous motions for summary judgment concerning, among other things, infringement, validity, and other affirmative defenses. The District Court commenced a jury trial on April 13, 2009 regarding all liability issues for the four consolidated cases. On April 20, 2009, the Company and CSIRO executed a Memorandum of Understanding (MOU) setting forth the terms of a settlement and license agreement between the Company and CSIRO. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company agreed to make a one-time lump sum payment in consideration for a fully paid perpetual license and a covenant not to sue with respect to the '069 patent and all foreign counterparts and related patents. Based on the historical and estimated projected future unit sales of the Company's products that were alleged to infringe the asserted patent, the Company allocated a portion of the settlement cost towards product shipments prior to the settlement, which the Company recorded as a litigation settlement expense of \$2.4 million, which was primarily recognized in the three months ended March 29, 2009. Additionally, the Company allocated \$2.6 million of the settlement cost to prepaid royalties which will be recognized as a component of cost of revenue as the related products are sold. Of this \$2.6 million, \$413,000 and \$551,000 were amortized and expensed in the year ended December 31, 2009 and December 31, 2010, respectively. Additionally, \$551,000 was amortized and expensed in the year ended December 31, 2011.

*Finoc, LLC v. NETGEAR*

In February 2009, a lawsuit was filed against the Company and 14 other companies by Finoc Design Consulting OY (Finoc) in the U.S. District Court for the Eastern District of Texas. Finoc alleged that the Company's wireless DSL gateway products infringe U.S. Patent No. 6,850,560. In June 2009, without admitting any patent infringement, wrongdoing or violation of law and to avoid the distraction and expense of continued litigation, the Company agreed to make a one-time lump sum payment of \$82,500 in consideration for a fully paid perpetual license to the patent in suit as well as a dismissal with prejudice by Finoc. Based on the historical and estimated projected future unit sales of the Company's products that were alleged to infringe the asserted patents, the Company allocated a portion of the settlement cost towards product shipments prior to the settlement, which the Company recorded as a litigation settlement expense in the three months ended June 28, 2009. Additionally, the Company allocated the balance of the settlement cost to prepaid royalties, which will be recognized as a component of cost of revenue as the related products are sold.

*Network-1 Security Solutions, Inc. v. NETGEAR*

In February 2008, a lawsuit was filed against the Company by Network-1 Security Solutions, Inc. (Network-1), a patent-holding company existing under the laws of the State of Delaware, in the U.S. District Court for the Eastern District of Texas. Network-1 alleged that the Company's power over Ethernet (PoE) products infringed

**Table of Contents**

its U.S. Patent No. 6,218,930. Network-1 also sued six other companies alleging similar claims of patent infringement. The Company filed its answer in the second quarter of 2008. In May 2009, without admitting any patent infringement, wrongdoing or violation of law and to avoid the distraction and expense of continued litigation, the Company agreed to make a one-time lump sum payment of \$350,000, which the Company recorded as a litigation settlement in fiscal 2009, in consideration for a license to the patent in suit as well as a dismissal with prejudice of the lawsuit. Under the license, the Company will pay future running royalties on certain of its PoE products which will be recognized as a component of cost of revenue as the related products are sold.

*Chalumeau Power Systems v. NETGEAR.*

On June 28, 2011, Chalumeau Power Systems LLC ( Chalumeau ) filed a complaint against several technology companies including the Company, Cisco Systems Inc., Hewlett-Packard Co., D-Link, and Avaya Inc. in the U.S. District Court, District of Delaware alleging infringement of a patent for a remote device detection method. The patent number is U.S. Patent No. 5,991,885 ( 885 Patent) and is entitled Method and apparatus for detecting the presence of a remote device and providing power thereto. Chalumeau claimed that the defendants have all made or sold devices that make use of infringing PoE technology, which allows electrical power and data to pass safely on Ethernet cabling. The Company answered Chalumeau s complaint on September 1, 2011, and asserted various defenses and counterclaims, including those of noninfringement and invalidity of the 885 Patent. In October 2011, a settlement of this lawsuit was reached between Chalumeau and the Company through a third-party intermediary. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company and Chalumeau signed a binding release agreement in which both parties agreed to mutual general releases from all claims, known or unknown, under the 885 Patent and its foreign counterparts with respect to the manufacture, use, sale, etc. of products by the Company. The Court has since dismissed Chalumeau s claims for relief against the Company and the Company s counterclaims for relief against Chalumeau, with prejudice and with all attorneys fees, costs and expenses levied against the party incurring the same.

*Powerline Innovations, LLC v. NETGEAR*

On August 6, 2011 the Company, along with 16 other companies, was sued in the U.S. District Court, Eastern District of Texas, Tyler Division for patent infringement by a non-practicing entity called Powerline Innovations, LLC ( Powerline Innovations ). This is a single patent case, involving U.S. Patent No. 5,471,190, entitled Method and Apparatus for Resource Allocation in a Communication Network System. On the same day that it filed suit against the Company and 16 other companies, Powerline Innovations sued 14 additional companies in a separate suit in U.S. District Court, Eastern District of Texas for infringement of the same patent. The complaint against the Company alleges that it infringes the 5,471,190 patent based on the Company s use of methods for establishing control relationships between plural devices and names the Company s Powerline AV Ethernet Adapter, Model XAV101, as an accused infringing product. The Company answered the plaintiff s complaint on December 12, 2011, and asserted that it has not infringed the patent in suit and that the patent in suit is invalid. In addition, the Company asserted various affirmative defenses. Powerline Innovations has not yet served all the parties. The Court will likely not set an initial status conference before service is completed.

*Summit Data Systems LLC v. NETGEAR.*

On September 1, 2010, a non-practicing entity, Summit Data Systems LLC ( Summit Data Systems ), sued the Company and seven other companies in the U.S. District Court, District of Delaware alleging infringement of two patents U.S. Patent No. 7,392,291 ( 291 Patent), entitled Architecture for Providing Block-Level Access over a Computer Network and U.S. Patent No. 7,428,581 ( 581 Patent), entitled Architecture for Providing Block-Level Access over a Computer Network. The 581 Patent is a continuation of the 291 Patent. The Company s ReadyNAS and NVX products were listed by the plaintiff in the complaint as accused infringing

---

**Table of Contents**

products. The Company answered the complaint on November 1, 2010, asserting that the patents are not infringed and invalid. Subsequently, the Company participated in discovery, and trial for this matter was scheduled for March 2013. In October 2011, a settlement of this lawsuit was reached between Summit Data Systems and the Company through a third-party intermediary. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company and Summit Data Systems signed a binding release agreement in which both parties agreed to mutual general releases from all claims, known or unknown, under the 291 Patent and 581 Patents and certain other patents and applications assigned to Summit Data Systems with respect to the manufacture, use, sale, etc. of products by the Company. The Court has since dismissed Summit Data Systems' claims for relief against the Company and the Company's counterclaims for relief against Summit Data Systems, with prejudice and with all attorneys' fees, costs and expenses levied against the party incurring the same.

*NETGEAR v. Innovatio IP Ventures LLC.*

On November 16, 2011, the Company filed a declaratory judgment action in the District of Delaware for non-infringement and invalidity of 17 WiFi-related patents brought in the approximately 15 actions throughout the United States by Innovatio IP Ventures LLC (Innovatio) against end user customers of the Company and other companies. Shortly after filing the declaratory judgment action, the Company filed a response supporting Cisco Systems, Inc.'s and Motorola Solutions, Inc.'s Motion to Transfer for Coordinated Pretrial Proceedings Pursuant to 28 U.S.C. § 1407 that was before the United States Judicial Panel on Multidistrict Litigation (JPML). The pending motion to transfer would serve to consolidate all of the Innovatio lawsuits including NETGEAR's pending declaratory judgment action in Delaware and transfer them to a single court for coordinated pretrial proceedings. On December 28, 2011, the JPML issued an order transferring the Innovatio actions throughout the United States, including the Company's declaratory judgment action, to the United States District Court for the Northern District of Illinois. Thus, the Company's declaratory judgment action and approximately 15 other similar cases will now proceed in the Northern District of Illinois in a consolidated fashion. The Court has set a status conference date for the consolidated cases of March 27, 2012.

*Harris Corporation v. NETGEAR.*

On November 26, 2011, Harris Corporation (Harris) sued the Company in the U.S. District Court, Middle District of Florida alleging that the Company willfully infringes six of Harris's patents U.S. Patent Nos. 6,504,515, 7,916,684, 5,787,177, 5,974,149, 6,189,104, and 6,397,336. The Company obtained an extension until February 20, 2012 to answer the complaint and is reviewing the complaint and patents. It appears that Harris is attempting to read four of the patents (the 177, 149, 104, and 336 Patents) on the Company's ProSecure UTM series of products. The other two patents (the 515 and 684 Patents) allegedly read on certain of the Company's access points and wireless routers and gateways with multiple antennas. Harris filed an amended complaint on February 17, 2012 that removed its initial allegations of willful infringement by the Company and also removed the allegations of direct infringement against the Company for U.S. Patent No. 7,916,684, leaving only indirect infringement allegations for the 684 Patent. The Company's answer to the amended complaint is due on March 2, 2012.

*IP Indemnification Claims*

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 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.

**Table of Contents**

In June 2006, the Company received a request for indemnification from Charter and Charter Communications Operating, LLC, related to a lawsuit filed in the U.S. District Court, Eastern District of Texas, by Rembrandt Technologies, L.P. ( Rembrandt ), a patent-holding company. Rembrandt also filed a similar lawsuit in the same jurisdiction against Comcast Corporation, Comcast Cable Communications, LLC and Comcast of Plano, LP. Rembrandt alleged that products implementing the DOCSIS standard, which are supplied to Charter, Comcast Corporation, Comcast Cable Communications, LLC and Comcast of Plano, LP by, among others, the Company, infringe various patents held by Rembrandt. In June 2007, the Judicial Panel on Multidistrict Litigation ordered these and other similar patent cases brought by Rembrandt consolidated and transferred to the U.S. District Court for the District of Delaware. In November 2007, the Company along with Motorola, Inc., Cisco Systems, Inc., Scientific-Atlanta, Inc., ARRIS Group, Inc., Thomson, Inc. and Ambit Microsystems, Inc. filed a complaint for declaratory judgment in the U.S. District Court for the District of Delaware against Rembrandt, seeking a declaration that eight asserted Rembrandt patents asserted in the transferred cases are either invalid or not infringed. The District Court held a claim construction hearing on August 5, 2008. On November 29, 2008, the District Court issued its claim construction order. After the District Court's order, Rembrandt agreed to drop three patents from the case, leaving five patents at issue. The District Court held a mediation on March 3-4, 2009 but the parties were unable to reach a resolution. On July 21, 2009, Rembrandt delivered to the Company and other parties an executed covenant not to sue on any of the eight patents originally in the suit, contending that the execution of the covenant divests the District Court of jurisdiction or renders moot the remaining claims and counterclaims in the action. On July 31, 2009, Rembrandt filed a motion to dismiss the litigation. While Rembrandt's motion was pending, the defendants filed motions for summary judgment, motions for sanctions, and responses to Rembrandt's motion to dismiss. In early October 2009, the District Court suspended all further dates for the case while it reviewed the pending motions and case status. On October 23, 2009, the Court ordered Rembrandt to supplement the covenant not to sue to include any products or services that comply with DOCSIS 1.0, 1.1, 2.0 or 3 and dismissed Rembrandt's various infringement claims on the eight patents with prejudice. The Court gave Rembrandt five days to withdraw its motion to dismiss the litigation if it found the Court's conditions on dismissal to be unacceptable. Rembrandt did not withdraw its motion to dismiss the litigation, and on October 30, 2009, Rembrandt executed a covenant not to sue on any of the eight patents in the case and any products or services that comply with DOCSIS 1.0, 1.1, 2.0 or 3. The Company and its co-defendants moved for attorneys' fees to be paid by Rembrandt. Rembrandt opposed the motion. On July 8, 2011, the Court denied the defendant's unopposed motion for summary judgment of noninfringement of the one patent remaining in the case, the '627 Patent. This ruling did not affect the Company since that patent was not asserted against the Company, other than postponing the Company's possible recovery of attorneys' fees. On July 13, 2011, the Court dismissed without prejudice the defendants' joint motion for fees because the motion is now not ripe given the Court's denial of the motion for summary judgment of noninfringement of the '627 Patent. The Company is now reviewing its options for recovering attorneys' fees.

All of the above described claims against the Company, or filed by the Company, whether meritorious or not, could be time-consuming, result in costly litigation, require significant amounts of management time, and result in the diversion of significant operational resources. Were an unfavorable outcome to occur, there exists the possibility it would have a material adverse impact on the Company's financial position and results of operations for the period in which the unfavorable outcome occurs or becomes probable. In addition, the Company is subject to legal proceedings, claims and litigation arising in the ordinary course of business, including litigation related to intellectual property and employment matters.

Based on currently available information, the Company does not believe that the ultimate outcomes of any unresolved matters, individually and in the aggregate, are likely to have a material adverse effect on the Company's financial position, liquidity or results of operations within the next 12 months. However, litigation is subject to inherent uncertainties, and the Company's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Company's financial position and results of operations or liquidity for the period in which the unfavorable outcome occurs or becomes probable, and potentially in future periods.

---

**Table of Contents**

***Environmental Regulation***

The European Union ( EU ) has enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods, including home and commercial business networking products, financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for the individual member states of the EU to transpose the directive into law in their respective countries was August 13, 2004 (such legislation, together with the directive, the WEEE Legislation ). Producers participating in the market were financially responsible for implementing these responsibilities under the WEEE Legislation beginning in August 13, 2005. Similar WEEE Legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China, India, Australia and Japan. The Company adopted the authoritative guidance for asset retirement and environmental obligations in the third quarter of fiscal 2005 and has determined that its effect did not have a material impact on the Company s consolidated results of operations and financial position for the full year ended December 31, 2011. The Company is continuing to evaluate the impact of the WEEE Legislation and similar legislation in other jurisdictions as individual countries issue their implementation guidance.

Additionally, the EU has enacted the Restriction of Hazardous Substances Directive ( RoHS Legislation ), the REACH Directive and the Battery Directive. EU RoHS Legislation, along with similar legislation in China, requires manufacturers to ensure certain substances, including polybrominated biphenyls ( PBD ), polybrominated diphenyl ethers ( PBDE ), mercury, cadmium, hexavalent chromium and lead (except for allowed exempted materials and applications), are below specified maximum concentration values in certain products put on the market after July 1, 2006. The REACH Directive similarly requires manufacturers to ensure the published list of substances of very high concern in certain products are below specified maximum concentration values. The Battery Directive prohibits use of certain types of battery technology in certain products. The Company believes it has met the requirements of the RoHS Legislation, the REACH Directive and the Battery Directive.

Additionally, the EU has enacted the Energy Using Product ( EuP ) Directive, which requires manufacturers of certain products to meet minimum energy efficiency limits. These limits are documented in EuP implementing measures issued for specific types of equipment and document minimum power supply efficiencies and may include required equipment standby modes which also reduce energy consumption. The Company believes it has met the requirements of the applicable EuP implementing measures.

**Note 10 Stockholders Equity**

***Common Stock Repurchase Programs***

In October 21, 2008, the Company s Board of Directors authorized management to repurchase up to 6,000,000 shares of the Company s outstanding common stock. Under this authorization, 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. The Company did not repurchase any shares under this authorization during the years ended December 31, 2011, 2010 or 2009.

The Company repurchased approximately 25,000 shares, or \$926,000 of common stock under a repurchase program to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the year ended December 31, 2011. Similarly, during the years ended December 31, 2010 and December 31, 2009, the Company repurchased approximately 32,000 shares and 22,000 shares, respectively, or \$736,000 and \$282,000 of common stock, respectively, under the same program to help facilitate tax withholding for 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.

**Table of Contents*****Comprehensive Income and Cumulative Other Comprehensive Income, Net***

The following table sets forth the activity for each component of other comprehensive income, net of related taxes, for the years ended December 31, 2011, December 31, 2010, and December 31, 2009, (in thousands):

	Year ended December 31,		
	2011	2010	2009
Net income	\$ 91,368	\$ 50,909	\$ 9,333
Unrealized gains (losses) on derivative instruments	(267)	253	20
Unrealized gains (losses) on available-for-sale securities	9	4	(63)
Total comprehensive income	\$ 91,110	\$ 51,166	\$ 9,290

The following table sets forth the components of cumulative other comprehensive income, net of related taxes, as of December 31, 2011 and December 31, 2010 (in thousands):

	As of December 31,	
	2011	2010
Net unrealized gains on derivative instruments	\$ 6	\$ 273
Net unrealized gains on available-for-sale securities	17	8
Total cumulative other comprehensive income, net of taxes	\$ 23	\$ 281

**Note 11 Employee Benefit Plans*****2000 Stock Option Plan***

In April 2000, the Company adopted the 2000 Stock Option Plan (the 2000 Plan). The 2000 Plan provides for the granting of stock options to employees and consultants of the Company. Options granted under the 2000 Plan may be either incentive stock options (ISOs) or nonqualified stock options (NSOs). ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. A total of 7,350,000 shares of Common Stock have been reserved for issuance under the 2000 Plan.

Options under the 2000 Plan may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. To date, options granted generally vest over four years.

As discussed below, in April 2003, all remaining shares reserved but not issued under the 2000 Plan were transferred to the 2003 Stock Plan.

***2003 Stock Plan***

In April 2003, the Company adopted the 2003 Stock Plan (the 2003 Plan). The 2003 Plan provides for the granting of stock options to employees and consultants of the Company. Options granted under the 2003 Plan may be either ISOs or NSOs. ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. The Company has reserved 750,000 shares of Common Stock plus any shares which were reserved but not issued under the 2000 Plan as of the date of the approval of the 2003 Plan. The number of shares which were reserved but not issued under the 2000 Plan that were transferred to the Company's 2003 Plan were 615,290, which when



---

**Table of Contents**

combined with the shares reserved for the Company's 2003 Plan total 1,365,290 shares reserved under the Company's 2003 Plan as of the date of transfer. Any options cancelled under either the 2000 Plan or the 2003 Plan are returned to the pool available for grant. As of December 31, 2011, 255,445 shares were reserved for future grants under the Company's 2003 Plan.

Options under the 2003 Plan may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. To date, options granted generally vest over four years, with the first tranche vesting at the end of 12 months and the remaining shares underlying the option vesting monthly over the remaining three years. In fiscal 2005, certain options granted under the 2003 Plan immediately vested and were exercisable on the date of grant, and the shares underlying such options were subject to a resale restriction which expires at a rate of 25% per year.

***2006 Long Term Incentive Plan***

In April 2006, the Company adopted the 2006 Long Term Incentive Plan (the "2006 Plan"), which was approved by the Company's stockholders at the 2006 Annual Meeting of Stockholders on May 23, 2006. The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, performance awards and other stock awards, to eligible directors, employees and consultants of the Company. Upon the adoption of the 2006 Plan, the Company reserved 2,500,000 shares of common stock for issuance under the 2006 Plan. In June 2008, the Company adopted amendments to the 2006 Plan which increased the number of shares of the Company's common stock that may be issued under the 2006 plan by an additional 2,500,000 shares. In July 2010, the Company adopted amendments to the 2006 Plan which increased the number of shares of the Company's common stock that may be issued under the 2006 plan by an additional 1,500,000 shares. As of December 31, 2011, 486,349 shares were reserved for future grants under the 2006 Plan.

Options granted under the 2006 Plan may be either ISOs or NSOs. ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. Options may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. Options granted under the 2006 Plan generally vest over four years, with the first tranche vesting at the end of 12 months and the remaining shares underlying the option vesting monthly over the remaining three years.

Stock appreciation rights may be granted under the 2006 Plan subject to the terms specified by the plan administrator, provided that the term of any such right may not exceed ten (10) years from the date of grant. The exercise price generally cannot be less than the fair market value of the Company's common stock on the date the stock appreciation right is granted.

Restricted stock awards may be granted under the 2006 Plan subject to the terms specified by the plan administrator. The period over which any restricted award may fully vest is generally no less than three (3) years. Restricted stock awards are non-vested stock awards that may include grants of restricted stock or grants of restricted stock units ("RSUs"). Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. During that period, ownership of the shares cannot be transferred. Restricted stock has the same voting rights as other common stock and is considered to be currently issued and outstanding. RSUs do not have the voting rights of common stock, and the shares underlying the RSUs are not considered issued and outstanding. The Company expenses the cost of the restricted stock awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse.



## **Table of Contents**

Performance awards may be in the form of performance shares or performance units. A performance share means an award denominated in shares of Company common stock and a performance unit means an award denominated in units having a dollar value or other currency, as determined by the plan administrator. The plan administrator will determine the number of performance awards that will be granted and will establish the performance goals and other conditions for payment of such performance awards. The period of measuring the achievement of performance goals will be a minimum of twelve (12) months.

Other stock-based awards may be granted under the 2006 Plan subject to the terms specified by the plan administrator. Other stock-based awards may include dividend equivalents, restricted stock awards, or amounts which are equivalent to all or a portion of any federal, state, local, domestic or foreign taxes relating to an award, and may be payable in shares, cash, other securities or any other form of property as the plan administrator may determine.

In the event of a change in control of the Company, all awards under the 2006 Plan vest in full and all outstanding performance shares and performance units will be paid out upon transfer.

Any shares of common stock subject to an award that is forfeited, settled in cash, expires or is otherwise settled without the issuance of shares shall again be available for awards under the 2006 Plan. Additionally, any shares that are tendered by a participant of the 2006 Plan or retained by the Company as full or partial payment to the Company for the purchase of an award or to satisfy tax withholding obligations in connection with an award shall no longer again be made available for issuance under the 2006 Plan.

The number of full value equity awards (as defined below) that may be granted will be limited to no more than ten percent (10%) of the shares issuable under the 2006 Plan. For these purposes, a full value equity award is any award pursuant to the 2006 Plan, other than options, stock appreciation rights or other awards which are based solely on an increase in value of the Company's common stock following the date of grant.

### ***Employee Stock Purchase Plan***

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. Employees may purchase stock semi-annually at a price equal to 85% of the fair market value on the purchase date. Since the price of the shares is determined at the purchase date, the Company recognizes expense based on the 15% discount at purchase. For the years ended December 31, 2011, 2010 and 2009, ESPP compensation expense was \$354,000, \$236,000 and \$184,000, respectively. As of December 31, 2011, 450,669 shares were reserved for future grants under the ESPP.

**Table of Contents****Option Activity**

Stock options activity under the stock option plans during the years ended December 31, 2011, 2010, and 2009 were as follows:

	Number of Shares (In thousands)	Weighted Average Exercise Price Per Share (In dollars)	Outstanding Options	
			Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
December 31, 2008	3,916	\$ 21.00		
Granted	1,526	14.72		
Exercised	(370)	8.07		
Cancelled	(452)	21.19		
December 31, 2009	4,620	\$ 19.94		
Granted	1,368	26.03		
Exercised	(1,339)	15.02		
Cancelled	(282)	21.80		
December 31, 2010	4,367	\$ 23.24		
Granted	1,290	34.58		
Exercised	(1,381)	22.37		
Cancelled	(326)	25.90		
December 31, 2011	3,950	\$ 27.03	7.65	\$ 28,672

As of December 31, 2011:

Vested and expected to vest	3,648	\$ 26.86	7.56	\$ 26,982
Exercisable Options	1,690	\$ 24.42	6.20	\$ 15,994

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic values (the difference between the Company's closing stock price on the last trading day of 2011, 2010, and 2009 and the exercise price, multiplied by the number of shares underlying the in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2011, December 31, 2010, and December 31, 2009. This amount changes based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the year ended December 31, 2011, 2010 and 2009 was \$21.8 million, \$16.9 million and \$3.4 million, respectively.

The total fair value of options vested during the years ended December 31, 2011, 2010 and 2009 was \$9.8 million, \$9.1 million and \$9.0 million, respectively.

The following table summarizes significant ranges of outstanding and exercisable stock options as of December 31, 2011:

Range of Exercise Prices	Year ended December 31, 2011				
	Options Outstanding	Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price Per Share	Weighted-Average Exercise Price Per Share
	Shares Outstanding (In thousands)	Shares Exercisable (In thousands)	(In years)	(In dollars)	(In dollars)
\$0.00 - 10.00	7	7	1.01	\$ 6.29	\$ 6.29
10.01 - 20.00	726	450	6.32	13.66	13.95

Edgar Filing: NETGEAR, INC - Form 10-K

20.01 - 30.00	1,533	7.19	24.70	857	25.64
30.01 - 40.00	1,684	8.66	34.99	376	34.51
<b>Total</b>	<b>3,950</b>	<b>7.65</b>	<b>\$ 27.03</b>	<b>1,690</b>	<b>\$ 24.42</b>

**Table of Contents****RSU Activity**

RSU activity under during the years ended December 31, 2011, 2010, and 2009 were as follows:

	Number of Shares  (In thousands)	Outstanding RSUs		
		Weighted Average Grant Date Fair Value Per Share  (In dollars)	Weighted Average Remaining Contractual Term  (In years)	Aggregate Intrinsic Value (In thousands)
December 31, 2008	235	\$ 25.55		
RSUs granted	171	12.24		
RSUs vested	(104)	23.43		
RSUs cancelled	(15)	19.36		
December 31, 2009	287	18.71		
RSUs granted	48	22.73		
RSUs vested	(133)	19.30		
RSUs cancelled	(3)	11.41		
December 31, 2010	199	19.40		
RSUs granted	113	34.78		
RSUs vested	(118)	21.64		
RSUs cancelled	(17)	18.38		
December 31, 2011	177	\$ 27.86	1.60	\$ 5,939

Total intrinsic value of RSUs vested during the years ended December 31, 2011, 2010 and 2009 was \$4.4 million, \$3.1 million and \$1.4 million, respectively. The total fair value of RSUs vested during the years ended December 31, 2011, 2010 and 2009 was \$2.6 million, \$2.6 million and \$2.4 million, respectively.

**Valuation and Expense Information**

The fair value of each option award granted under the Company's ESPP equals the 15% discount at purchase. The fair value of each restricted stock unit under all share-based compensation plans equals the fair value of NETGEAR stock on the date of the grant. The fair value of each option award granted under all other share-based compensation plans is estimated on the date of grant using the Black-Scholes-Merton option valuation model and the weighted average assumptions in the following table. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk free interest rate is based on the implied yield currently available on U.S. Treasury securities with an equivalent remaining term. Expected volatility is based on a combination of the historical volatility of the Company's stock as well as the historical volatility of certain of the Company's industry peers' stock. The Company estimated the forfeiture rate for the years ended December 31, 2011, 2010 and 2009 based on its historical experience.

	Stock Options Granted Under non-ESPP Plans Year Ended December 31,		
	2011	2010	2009
Expected life (in years)	4.4	4.4	4.4
Risk-free interest rate	1.63%	1.74%	1.73%
Expected volatility	50.31%	49.87%	50.48%
Dividend yield			

The weighted average estimated fair value of options granted during the years ended December 31, 2011, 2010 and 2009 including options granted under the ESPP and not including restricted stock units, were \$14.29, \$10.80 and \$6.10, respectively.



**Table of Contents**

The following table sets forth the total stock-based compensation expense resulting from stock options, restricted stock awards, and the Employee Stock Purchase Plan included in the Company's Consolidated Statements of Operations (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Cost of revenue	\$ 999	\$ 913	\$ 959
Research and development	2,476	2,271	1,973
Sales and marketing	5,136	4,710	4,147
General and administrative	5,151	4,307	3,945
	\$ 13,762	\$ 12,201	\$ 11,024

The Company recognizes these compensation costs net of the estimated forfeitures on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years.

Total stock-based compensation cost capitalized in inventory was less than \$250,000 in each of the years ended December 31, 2011, 2010 and 2009.

As of December 31, 2011, \$21.8 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.45 years. As of December 31, 2011, \$2.5 million of total unrecognized compensation cost related to non-vested RSUs is expected to be recognized over a weighted-average period of 1.17 years.

**401k**

In April 2000, the Company adopted the NETGEAR 401(k) Plan to which employees may contribute up to 100% of salary subject to the legal maximum. Beginning on January 1, 2009 for the first three pay periods of 2009 only, which ended on January 30, 2009, the Company contributed an amount equal to 100% of the employee contributions up to a maximum of \$7,000, for employees that remained active with the company through December 31, 2009. No match was offered in 2010 and 2011. The Company expensed zero, zero and \$508,000 related to the NETGEAR 401(k) Plan in the years ended December 31, 2011, 2010, and 2009, respectively.

**Note 12 Segment Information, Operations by Geographic Area and Customer Concentration**

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the Chief Operating Decision Maker ( CODM ) of an organization, in order to determine operating and resource allocation decisions. By this definition, the Company operated in one business segment through the first fiscal quarter of 2011, which comprised the development, marketing and sale of networking products for the commercial business and home markets.

In the second fiscal quarter of 2011, the Company made organizational changes that resulted in changes to the way in which the CODM manages and evaluates the business. The Company's business is now managed in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home networking, storage and digital media products to connect people with the Internet and their content and devices. The commercial business unit consists of business networking, storage and security solutions without the cost and complexity of Big IT. The service provider business unit consists of made-to-order and retail proven, whole home networking solutions sold to service providers for sale to their customers. Each business unit is managed by a Senior Vice President/General Manager. There is no change in the CODM before and after the reorganization of the segments.

**Table of Contents**

The Company believes this new structure enables it to better focus its efforts on the Company's core customer segments and allows it to be more nimble and opportunistic as a company overall. The business units are determined in accordance with how management views and evaluates the Company's business and based on the criteria as outlined in the authoritative guidance. As a result, beginning in the second fiscal quarter of 2011, the Company changed its segment reporting accordingly, and revised its prior period presentation to conform to the new segments.

The results of the reportable segments are derived directly from the Company's management reporting system. The results are based on the Company's method of internal reporting and are not necessarily in conformity with accounting principles generally accepted in the United States. Management measures the performance of each segment based on several metrics, including contribution income. Refer to the reconciliation of segment information to the Company's consolidated totals below to see the reconciliation of segment data to earnings prepared in conformity with accounting principles generally accepted in the United States.

Asset data is not reviewed by the Company's CODM at the segment level and therefore is not presented. Discrete financial information on individual products and services within the respective segments is not reviewed by the Company's CODM, and therefore a separate disclosure of similar classes of products and services below the segment level is not presented. Financial information for each reportable segment and a reconciliation of segment contribution income to income before income taxes is as follows (in thousands, except percentage data):

	Year Ended December 31,		
	2011	2010	2009
<b>Net revenues:</b>			
Retail	\$ 481,795	\$ 435,484	\$ 288,728
Commercial	331,439	284,539	209,953
Service Provider	367,784	182,029	187,914
<b>Total net revenues</b>	<b>1,181,018</b>	<b>902,052</b>	<b>686,595</b>
<b>Contribution income:</b>			
Retail	\$ 81,589	\$ 71,862	\$ 24,901
<i>Retail contribution margin</i>	<i>16.9%</i>	<i>16.5%</i>	<i>8.6%</i>
Commercial	74,746	63,021	43,255
<i>Commercial contribution margin</i>	<i>22.6%</i>	<i>22.1%</i>	<i>20.6%</i>
Service Provider	32,797	14,026	19,697
<i>Service Provider contribution margin</i>	<i>8.9%</i>	<i>7.7%</i>	<i>10.5%</i>
<b>Total segment contribution income</b>	<b>189,132</b>	<b>148,909</b>	<b>87,853</b>
Corporate and unallocated costs	(43,301)	(39,244)	(34,248)
Amortization of intangible assets	(4,658)	(5,293)	(5,013)
Stock-based compensation expense	(13,762)	(12,201)	(11,024)
Restructuring and other charges	(2,094)	88	(809)
Technology license agreements			(2,500)
Acquisition related compensation	(40)	(686)	(113)
Impact to cost of sales from acquisition accounting adjustments to inventory	(609)		
Litigation reserves, net	201	(211)	(2,080)
Interest income	477	426	629
Other income (expense), net	(1,136)	(564)	(128)
<b>Income before income taxes</b>	<b>\$ 124,210</b>	<b>\$ 91,224</b>	<b>\$ 32,567</b>

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





**Table of Contents**

segments because they are separately managed at the corporate level. These unallocated indirect costs include corporate costs, such as corporate research and development, general and administrative costs, stock-based compensation expenses, amortization of intangibles, acquisition-related integration costs, restructuring costs, litigation reserves and interest and other income (expense), net.

In the first fiscal quarter of 2011, in order to achieve operational efficiencies, the Company combined its North American, Central American and South American sales forces to form the Americas territory. Previously, North America was its own geographic region and the Central American and South American territories were categorized within the Asia Pacific geographic region. Following this change, the Company is organized into the following three geographic territories: Americas, EMEA and Asia Pacific. The Company has reclassified the disclosure of net revenue by geography for prior periods to conform to the current period's presentation. The change did not result in material differences from what was previously reported. Net revenue by geography comprises gross revenue less such items as end-user customer rebates and other sales incentives deemed to be a reduction of net revenue per the authoritative guidance for revenue recognition, sales returns and price protection. For reporting purposes revenue is attributed to each geographic region based on the location of the customer. The following table shows net revenue by geography for the periods indicated (in thousands):

	Year Ended December 31,		
	2011	2010	2009
United States	\$ 570,143	\$ 454,179	\$ 310,937
Americas (excluding U.S.)	16,913	12,363	7,636
United Kingdom	165,522	100,357	92,663
EMEA (excluding U.K.)	312,191	239,892	199,677
Asia Pacific	116,249	95,261	75,682
Total net revenue	\$ 1,181,018	\$ 902,052	\$ 686,595

Long-lived assets, comprising fixed assets, are reported based on the location of the asset. Long-lived assets by geographic location are as follows (in thousands):

	Year Ended December 31,	
	2011	2010
United States	\$ 9,901	\$ 11,808
Americas (excluding U.S.)	44	22
EMEA	331	205
China	4,909	4,848
Asia Pacific (excluding China)	699	620
	\$ 15,884	\$ 17,503

Customer concentration (as a percentage of net revenue):

	Year Ended December 31,		
	2011	2010	2009
Best Buy Co., Inc. and Affiliates	11%	15%	11%
Ingram Micro, Inc. and Affiliates	10%	11%	11%
All others individually less than 10% of revenue	79%	74%	78%
	100%	100%	100%

**Note 13 Fair Value of Financial Instruments**

## Edgar Filing: NETGEAR, INC - Form 10-K

The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when

**Table of Contents**

measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The following tables summarize the valuation of the Company's financial instruments by the above categories as of December 31, 2011 and December 31, 2010:

	Total	As of December 31, 2011		
		Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash equivalents money market funds	\$ 24,844	\$ 24,844	\$	\$
Available-for-sale securities Treasuries(1)	144,703	144,703		
Available-for-sale securities Certificates of Deposit(1)	94	94		
Foreign currency forward contracts(2)	1,237		1,237	
<b>Total</b>	<b>\$ 170,878</b>	<b>\$ 169,641</b>	<b>\$ 1,237</b>	<b>\$</b>

(1) Included in short-term investments on the Company's consolidated balance sheet.

(2) Included in prepaid expenses and other current assets on the Company's consolidated balance sheet.

	Total	As of December 31, 2011		
		Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Foreign currency forward contracts(3)	\$ (723)	\$	\$ (723)	\$
<b>Total</b>	<b>\$ (723)</b>	<b>\$</b>	<b>\$ (723)</b>	<b>\$</b>

(3) Included in other accrued liabilities on the Company's consolidated balance sheet.

	Total	As of December 31, 2010		
		Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)

Edgar Filing: NETGEAR, INC - Form 10-K

Cash equivalents money market funds	\$ 77,795	\$ 77,795	\$	\$
Available-for-sale securities Treasuries(1)	144,564	144,564		
Foreign currency forward contracts(2)	1,389		1,389	
Total	\$ 223,748	\$ 222,359	\$ 1,389	\$

- (1) Included in short-term investments on the Company's consolidated balance sheet.
- (2) Included in prepaid expenses and other current assets on the Company's consolidated balance sheet.

**Table of Contents**

	As of December 31, 2010			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Foreign currency forward contracts(3)	\$ (789)	\$	\$ (789)	\$
Total	\$ (789)	\$	\$ (789)	\$

(3) Included in other accrued liabilities on the Company's consolidated balance sheet.

The Company's investments in cash equivalents and available for sale 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 enters into foreign currency forward contracts with only those counterparties that have long-term credit ratings of A+/A2 or higher. 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. Additionally, the Company includes an adjustment for non-performance risk in the recognized measure of fair value of derivative instruments. At December 31, 2011 and December 31, 2010, the adjustment for non-performance risk did not have a material impact on the fair value of the Company's foreign currency forward contracts. 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.

**Table of Contents****QUARTERLY FINANCIAL DATA****(In thousands, except per share amounts)****(Unaudited)**

The following table presents unaudited quarterly financial information for each of the Company's last eight quarters. This information has been derived from the Company's unaudited financial statements and has been prepared on the same basis as the audited Consolidated Financial Statements appearing elsewhere in this Form 10-K. In the opinion of management, all necessary adjustments, consisting only of normal recurring adjustments, have been included to state fairly the quarterly results.

	<b>April 3, 2011</b>	<b>July 3, 2011</b>	<b>October 2, 2011</b>	<b>December 31, 2011</b>
Net revenue	\$ 278,823	\$ 291,240	\$ 301,800	\$ 309,155
Gross profit	\$ 87,786	\$ 90,377	\$ 96,310	\$ 94,973
Provision for income taxes	\$ 9,142	\$ 6,742	\$ 6,178	\$ 10,780
Net income	\$ 21,189	\$ 20,597	\$ 26,747	\$ 22,835
Net income per share - basic	\$ 0.58	\$ 0.56	\$ 0.71	\$ 0.61
Net income per share - diluted	\$ 0.57	\$ 0.54	\$ 0.70	\$ 0.60
	<b>March 28, 2010</b>	<b>June 27, 2010</b>	<b>October 3, 2010</b>	<b>December 31, 2010</b>
Net revenue	\$ 211,555	\$ 195,949	\$ 236,017	\$ 258,531
Gross profit	\$ 72,824	\$ 69,562	\$ 75,707	\$ 81,154
Provision for income taxes	\$ 9,856	\$ 10,567	\$ 8,435	\$ 11,457
Net income	\$ 13,727	\$ 10,465	\$ 13,095	\$ 13,622
Net income per share - basic	\$ 0.39	\$ 0.30	\$ 0.37	\$ 0.38
Net income per share - diluted	\$ 0.38	\$ 0.29	\$ 0.36	\$ 0.37

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

None.

**Item 9A. Controls and Procedures****Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework, issued by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessment using those criteria, our management concluded that our internal control over financial reporting was effective as of December 31, 2011. The effectiveness of our internal control over financial reporting as of December 31, 2011 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included in this Annual Report on Form 10-K.

**Changes in Internal Control Over Financial Reporting**

## Edgar Filing: NETGEAR, INC - Form 10-K

There was no change in our internal control over financial reporting that occurred during the fourth quarter of fiscal year 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

***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 Exchange Act were effective as of the end of the period covered by this Annual Report on Form 10-K to ensure that information required to be disclosed by us 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 SEC's rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Item 9B. *Other Information***

None.



**Table of Contents**

**PART III**

Certain information required by Part III is incorporated herein by reference from our proxy statement related to our 2012 Annual Meeting of Stockholders, which we intend to file no later than 120 days after the end of the fiscal year covered by this Form 10-K.

**Item 10. *Directors, Executive Officers and Corporate Governance***

The information required by this Item concerning our directors, executive officers and standing committees is incorporated by reference to the sections of our Proxy Statement under the headings Election of Directors, Board and Committee Meetings, and Section 16(a) Beneficial Ownership Reporting Compliance, and to the information contained in the section captioned Executive Officers of the Registrant included under Part I of this Form 10-K.

We have adopted a Code of Ethics that applies to our Chief Executive Officer and senior financial officers, as required by the SEC. The current version of our Code of Ethics can be found on our Internet site at <http://www.netgear.com>. Additional information required by this Item regarding our Code of Ethics is incorporated by reference to the information contained in the section captioned Corporate Governance Policies and Practices in our Proxy Statement.

We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of our Code of Ethics by posting such information on our website at <http://www.netgear.com> within four business days following the date of such amendment or waiver.

**Item 11. *Executive Compensation***

The information required by this Item is incorporated by reference to the sections of our Proxy Statement under the headings Compensation Discussion and Analysis, Executive Compensation, Director Compensation, Compensation Committee Interlocks and Insider Participation, and Report of the Compensation Committee of the Board of Directors.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this Item regarding equity compensation plans is incorporated by reference to the section entitled Equity Compensation Plan Information set forth in Item 5 of this Form 10-K.

The additional information required by this Item is incorporated by reference to the information contained in the section captioned Security Ownership of Certain Beneficial Owners and Management in our Proxy Statement.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

The information required by this Item is incorporated by reference to the information contained in the section captioned Election of Directors and Related Party Transactions in our Proxy Statement.

**Item 14. *Principal Accounting Fees and Services***

The information required by this Item related to audit fees and services is incorporated by reference to the information contained in the section captioned Ratification of Appointment of Independent Registered Public Accounting Firm appearing in our Proxy Statement.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedule**(a) *The following documents are filed as part of this report:*(1) *Financial Statements.*

<u>Report of Independent Registered Public Accounting Firm</u>	Page 56
<u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>	57
<u>Consolidated Statements of Operations for the three years ended December 31, 2011, 2010 and 2009</u>	58
<u>Consolidated Statements of Stockholders' Equity for the three years ended December 31, 2011, 2010 and 2009</u>	59
<u>Consolidated Statements of Cash Flows for the three years ended December 31, 2011, 2010 and 2009</u>	60
<u>Notes to Consolidated Financial Statements</u>	61
<u>Quarterly Financial Data (unaudited)</u>	109
<u>Management's Report on Internal Control Over Financial Reporting</u>	109
(2) <i>Financial Statement Schedule.</i>	

The following financial statement schedule of NETGEAR, Inc. for the fiscal years ended December 31, 2011, 2010 and 2009 is filed as part of this Form 10-K and should be read in conjunction with the Consolidated Financial Statements of NETGEAR, Inc.

**Schedule II Valuation and Qualifying Accounts****(In thousands)**

	Balance at Beginning of Year	Additions	Deductions	Balance at End of Year
<b>Allowance for doubtful accounts:</b>				
Year ended December 31, 2011	\$ 1,481	\$ (21)	\$ (125)	\$ 1,335
Year ended December 31, 2010	2,038	(202)	(355)	1,481
Year ended December 31, 2009	1,918	217	(97)	2,038
<b>Allowance for sales returns and product warranty:</b>				
Year ended December 31, 2011	50,786	86,310	(78,890)	58,206
Year ended December 31, 2010	42,603	78,280	(70,097)	50,786
Year ended December 31, 2009	38,317	67,340	(63,054)	42,603
<b>Allowance for price protection:</b>				
Year ended December 31, 2011	3,147	15,688	(14,905)	3,930
Year ended December 31, 2010	1,545	13,011	(11,409)	3,147
Year ended December 31, 2009	3,430	6,563	(8,448)	1,545

(3) *Exhibits.* The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this report.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 29th day of February 2012.

NETGEAR, Inc.  
Registrant

/s/ PATRICK C.S. LO  
**Patrick C.S. Lo**

**Chairman of the Board and Chief Executive Officer**

**(Principal Executive Officer)**

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Patrick C.S. Lo and Christine M. Gorjanc, and each of them, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any and all amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ PATRICK C.S. LO <b>Patrick C.S. Lo</b>	Chairman of the Board and Chief Executive Officer <i>(Principal Executive Officer)</i>	February 29, 2012
/s/ CHRISTINE M. GORJANC <b>Christine M. Gorjanc</b>	Chief Financial Officer <i>(Principal Financial and Accounting Officer)</i>	February 29, 2012
/s/ JOCELYN CARTER-MILLER <b>Jocelyn Carter-Miller</b>	Director	February 29, 2012
/s/ RALPH E. FAISON <b>Ralph E. Faison</b>	Director	February 29, 2012
/s/ A. TIMOTHY GODWIN <b>A. Timothy Godwin</b>	Director	February 29, 2012

Edgar Filing: NETGEAR, INC - Form 10-K

/s/ JEF GRAHAM	Director	February 29, 2012
<b>Jef Graham</b>		
/s/ LINWOOD A. LACY, JR.	Director	February 29, 2012
<b>Linwood A. Lacy, Jr.</b>		
/s/ GREGORY J. ROSSMANN	Director	February 29, 2012
<b>Gregory J. Rossmann</b>		
/s/ BARBARA V. SCHERER	Director	February 29, 2012
<b>Barbara V. Scherer</b>		
/s/ JULIE A. SHIMER	Director	February 29, 2012
<b>Julie A. Shimer</b>		

**Table of Contents****INDEX TO EXHIBITS****Exhibit**

<b>Number</b>	<b>Description</b>
2.1**	Asset Purchase Agreement, dated as of September 22, 2008, by and among CP Secure International Holding Limited, the stockholders thereof and the registrant(1)
3.3	Amended and Restated Certificate of Incorporation of the registrant(2)
3.5	Amended and Restated Bylaws of the registrant(2)
4.1	Form of registrant's common stock certificate(2)
10.1	Form of Indemnification Agreement for directors and officers(2)
10.2#	2000 Stock Option Plan and forms of agreements thereunder(2)
10.3#	2003 Stock Plan and forms of agreements thereunder(2)
10.4#	2003 Employee Stock Purchase Plan(2)
10.5#	Offer Letter, dated December 3, 1999, between the registrant and Patrick C.S. Lo(2)
10.8#	Offer Letter, dated December 9, 1999, between the registrant and Mark G. Merrill(2)
10.9#	Employment Agreement, dated November 4, 2002, between the registrant and Michael F. Falcon(2)
10.10#	Employment Agreement, dated January 6, 2003, between the registrant and Charles T. Olson(2)
10.12#	Employment Agreement, dated November 16, 2005, between the registrant and Christine M. Gorjanc(3)
10.14*	Distributor Agreement, dated March 1, 1997, between the registrant and Tech Data Product Management, Inc.(2)
10.15*	Distributor Agreement, dated March 1, 1996, between the registrant and Ingram Micro Inc., as amended by Amendment dated October 1, 1996 and Amendment No. 2 dated July 15, 1998(2)
10.24*	Warehousing Agreement, dated July 5, 2001, between the registrant and APL, Logistics Americas, Ltd.(2)
10.25*	Distribution Operation Agreement, dated April 27, 2001, between the registrant and DSV Solutions B.V. (formerly Furness Logistics BV)(2)
10.26*	Distribution Operation Agreement, dated December 1, 2001, between the registrant and Kerry Logistics (Hong Kong) Limited(2)
10.33#	2006 Long Term Incentive Plan and forms of agreements thereunder(4)
10.34	Agreement and Plan of Merger, dated as of July 26, 2006, by and among the registrant, SKJM Holdings Corporation, SkipJam Corp., Michael Spilo, Jonathan Daub, Francis Refol, Dennis Aldover and Zhicheng Qiu(5)
10.41**	Agreement and Plan of Merger, dated as of May 2, 2007, by and among the registrant, NAS Holdings Corporation, Infrant Technologies, Inc., certain Infrant shareholders thereof, and Paul Tien as the Holders Representative(6)
10.44	Office Lease, dated as of September 25, 2007, by and between the registrant and BRE/Plumeria, LLC(7)
10.45	First Amendment to Office Lease, dated as of April 23, 2008, by and between the registrant and BRE/Plumeria, LLC(8)
10.46#	Amended and Restated 2006 Long-Term Incentive Plan(9)
10.47#	NETGEAR, Inc. Executive Bonus Plan(9)

**Table of Contents**

**Exhibit**

<b>Number</b>	<b>Description</b>
10.49#	Amendment to Employment Agreement, dated December 29, 2008, between the registrant and Michael F. Falcon(10)
10.50#	Amendment to Employment Agreement, dated December 31, 2008, between the registrant and Christine Gorjanc(10)
10.51#	Amendment to Offer Letter, dated December 23, 2008, between the registrant and Patrick Lo(10)
10.52#	Amendment to Offer Letter, dated December 28, 2008, between the registrant and Mark Merrill(10)
10.53#	Amendment to Employment Agreement, dated December 24, 2008, between the registrant and Chuck Olson(10)
10.54#	Amendment to Employment Agreement, dated December 30, 2008, between the registrant and Michael Werdann(10)
10.55#	Amendment #2 to Employment Agreement, dated September 21, 2009, between the registrant and Christine Gorjanc(11)
10.56#	Change of Control and Severance Agreement dated March 31, 2011 by and between NETGEAR, Inc. and David Soares(12)
21.1	List of subsidiaries and affiliates
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
24.1	Power of Attorney (included on signature page)
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	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
32.2	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
101***	XBRL Interactive Data Files

# Indicates management contract or compensatory plan or arrangement.

\* Confidential treatment has been granted as to certain portions of this Exhibit.

\*\* Registrant hereby agrees to furnish a copy of the omitted schedules and exhibits to the Securities and Exchange Commission upon its request.

\*\*\* XBRL Interactive Data Files with detailed tagging will be filed by amendment to this Annual Report on Form 10-K within 30 days of the filing date of this Annual Report on Form 10-K, as permitted by Rule 405(a)(2) of Regulation S-T.

**Table of Contents**

- (1) Incorporated by reference to the exhibit bearing the same number filed with the Registrant's Current Report on Form 8-K filed on September 23, 2008 with the Securities and Exchange Commission.
- (2) Incorporated by reference to an exhibit filed with the Registrant's Registration Statement on Form S-1 (Registration Statement 333-104419), which the Securities and Exchange Commission declared effective on July 30, 2003.
- (3) Incorporated by reference to Exhibit 10.32 of the Registrant's Current Report on Form 8-K filed on November 22, 2005 with the Securities and Exchange Commission.
- (4) Incorporated by reference to the copy included in the Registrant's Proxy Statement for the 2006 Annual Meeting of Stockholders filed on April 21, 2006 with the Securities and Exchange Commission.
- (5) Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K filed on July 27, 2006 with the Securities and Exchange Commission.
- (6) Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K filed on May 3, 2007 with the Securities and Exchange Commission.
- (7) Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on September 27, 2007 with the Securities and Exchange Commission.
- (8) Incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed on May 9, 2008 with the Securities and Exchange Commission.
- (9) Incorporated by reference to the copy included in the Registrant's Proxy Statement for the 2008 Annual Meeting of Stockholders filed on April 28, 2008 with the Securities and Exchange Commission.
- (10) Incorporated by reference to the copy included in the Registrant's Annual Report on Form 10-K filed on March 4, 2009 with the Securities and Exchange Commission.
- (11) Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on September 21, 2009 with the Securities and Exchange Commission.
- (12) Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on April 4, 2011 with the Securities and Exchange Commission.