NETGEAR, INC
Form 10-Q
May 04, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended April 1, 2018.

¨ 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	77-0419172
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
350 East Plumeria Drive, San Jose, California	95134
(Address of principal executive offices)	(Zip Code)

(408) 907-8000
(Registrant's telephone number including area code)
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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer	x	Accelerated filer	¨
Non-Accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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

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

The number of outstanding shares of the registrant's Common Stock, $0.001 par value, was 31,551,361 as of April 27, 2018.

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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements
NETGEAR, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of April 1, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$258,795	$202,870
Short-term investments	127,442	126,926
Accounts receivable, net	317,102	412,798
Inventories	266,345	245,894
Prepaid expenses and other current assets	29,849	27,176
Total current assets	999,533	1,015,664
Property and equipment, net	19,779	20,660
Intangibles, net	22,449	24,988
Goodwill	85,463	85,463
Other non-current assets	85,953	61,789
Total assets	$1,213,177	$1,208,564
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$96,371	$111,915
Accrued employee compensation	25,673	27,752
Other accrued liabilities	239,261	222,470
Deferred revenue	30,985	55,284
Income taxes payable	9,866	7,015
Total current liabilities	402,156	424,436
Non-current income taxes payable	32,089	31,544
Other non-current liabilities	23,213	22,099
Total liabilities	457,458	478,079
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock	32	31
Additional paid-in capital	615,876	603,137
Accumulated other comprehensive loss	(269)	(851)
Retained earnings	140,080	128,168
Total stockholders' equity	755,719	730,485
Total liabilities and stockholders' equity	$1,213,177	$1,208,564

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

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Net revenue	$344,973	$323,657
Cost of revenue	240,468	226,725
Gross profit	104,505	96,932
Operating expenses:		
Research and development	28,947	22,683
Sales and marketing	43,658	38,229
General and administrative	16,638	13,194
Separation expense	6,784	—
Restructuring and other charges	(9)	37
Total operating expenses	96,018	74,143
Income from operations	8,487	22,789
Interest income	748	405
Other income (expense), net	(1,252)	335
Income before income taxes	7,983	23,529
Provision for income taxes	2,393	7,535
Net income	$5,590	$15,994
Net income per share:		
Basic	$0.18	$0.49
Diluted	$0.17	$0.47
Weighted average shares used to compute net income per share:		
Basic	31,427	32,944
Diluted	32,660	34,136

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

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Net income	$5,590	$15,994
Other comprehensive income (loss), before tax:		
Unrealized gains (losses) on derivative instruments	692	(1,697)
Unrealized losses on available-for-sale securities	(38)	(55)
Other comprehensive income (loss), before tax	654	(1,752)
Tax benefit (provision) related to derivative instruments	(61)	196
Tax benefit (provision) related to available-for-sale securities	(11)	20
Other comprehensive income (loss), net of tax	582	(1,536)
Comprehensive income	$6,172	$14,458

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

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NETGEAR, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three Months Ended					
	April 1, 2018			April 2, 2017		
Cash flows from operating activities:						
Net income	$	5,590		$	15,994	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	5,887			7,866		
Purchase premium amortization/discount accretion on investments, net	(107		)	64		
Stock-based compensation	8,150			5,128		
Impairment charges on investment	1,400			—		
Deferred income taxes	(631		)	468		
Changes in assets and liabilities						
Accounts receivable	101,809			48,585		
Inventories	(22,819		)	(19,964		)
Prepaid expenses and other assets	(3,725		)	3,508		
Accounts payable	(14,994		)	(22,106		)
Accrued employee compensation	(2,079		)	(12,582		)
Other accrued liabilities	(27,434		)	(20,302		)
Deferred revenue	2,552			(2,722		)
Income taxes payable	3,397			5,324		
Net cash provided by operating activities	56,996			9,261		
Cash flows from investing activities:						
Purchases of short-term investments	(35,166		)	(33,917		)
Proceeds from maturities of short-term investments	34,907			33,894		
Purchases of property and equipment	(3,185		)	(3,434		)
Purchases of investments	—			(1,400		)
Payments made in connection with business acquisition, net of cash acquired	—			(737		)
	(3,444		)	(5,594		)

Net cash used in investing activities		
Cash flows from financing activities:		
Repurchases of common stock	—	(11,631)
Restricted stock unit withholdings	(2,271)	(1,936)
Proceeds from exercise of stock options	1,912	2,438
Proceeds from issuance of common stock under employee stock purchase plan	2,732	2,662
Net cash provided by (used in) financing activities	2,373	(8,467)
Net increase (decrease) in cash and cash equivalents	55,925	(4,800)
Cash and cash equivalents, at beginning of period	202,870	240,468
Cash and cash equivalents, at end of period	$ 258,795	$ 235,668

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

Note 1. The Company and Basis of Presentation

NETGEAR, Inc. (“NETGEAR” or the “Company”) was incorporated in Delaware in January 1996. The Company is a global company that delivers innovative networking and Internet connected products to consumers and growing businesses. The Company's products are built on a variety of proven technologies such as wireless (WiFi and LTE), Ethernet and powerline, with a focus on reliability and ease-of-use. The product line consists of devices that create and extend wired and wireless networks as well as devices that provide a special function and attach to the network, such as IP security cameras and home automation devices and services. These products are available in multiple configurations to address the changing needs of the customers in each geographic region in which the Company's products are sold.

The accompanying unaudited condensed consolidated financial statements include the accounts of NETGEAR, Inc. and its wholly owned subsidiaries. They have been prepared in accordance with established guidelines for interim financial reporting and with the instructions of Form 10-Q and Article 10 of Regulation S-X. All significant intercompany balances and transactions have been eliminated in consolidation. The balance sheet dated December 31, 2017 has been derived from audited financial statements at such date. Accordingly, these unaudited condensed consolidated financial statements do not include all of the information and footnotes typically found in the audited consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments considered necessary (consisting only of normal recurring adjustments) to fairly state the Company’s financial position, results of operations, comprehensive income and cash flows for the periods indicated. These unaudited condensed consolidated financial statements should be read in conjunction with the notes to the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.
The Company’s fiscal year begins on January 1 of the year stated and ends on December 31 of the same year. The Company reports its interim results on a fiscal quarter basis rather than on a calendar quarter basis. Under the fiscal quarter basis, each of the first three fiscal quarters ends on the Sunday closest to the calendar quarter end, with the fourth quarter ending on December 31.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities, (ii) the disclosure of contingent assets and liabilities at the date of the financial statements, and (iii) the reported amounts of net revenue and expenses during the reported period. Actual results could differ materially from those estimates and operating results for the three months ended April 1, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or any future period.

Planned Separation of Arlo Business

On February 6, 2018, the Company announced that its Board of Directors had unanimously approved the pursuit of a separation of its Arlo business from NETGEAR (the “Separation”). The Separation is expected to be effected through an initial public offering (“IPO”) of newly issued shares of the common stock of Arlo Technologies, Inc. (“Arlo”), which will hold the Arlo business. The Company expects Arlo to issue less than 20% of its common stock in the IPO, which is expected to be completed in the second half of fiscal 2018, with NETGEAR to retain the remaining interest. The Company currently intends that, following the IPO, it will complete the Separation by distributing the shares of Arlo common stock then held by NETGEAR to NETGEAR’s stockholders in a manner generally intended to qualify as tax-free to NETGEAR’s stockholders for U.S. federal income tax purposes (the “Distribution”). The Company also announced that it expects Matthew McRae, its Senior Vice President of Strategy, to serve as Arlo's Chief Executive Officer upon the completion of the IPO. In April 2018, the Company confidentially submitted a draft registration statement on Form S-1 to the U.S. Securities and Exchange Commission relating to the proposed IPO.

The Separation, including the IPO and the Distribution, will be subject to market, tax and legal considerations, final approval by the Company's Board of Directors and other customary requirements. This Quarterly Report on Form 10-Q does not constitute an offer to sell or a solicitation of an offer to buy securities, and shall not constitute an offer, solicitation or sale in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of that jurisdiction.

Note 2. Summary of Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Refer to Note 3. Revenue Recognition, for the updated accounting policy of revenue recognition upon the adoption of ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606) as of January 1, 2018.

Recent accounting pronouncements

Accounting Pronouncements Recently Adopted

ASU 2014-09

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606). The revenue recognition requirements in Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition ("ASC 605") is superseded by Topic 606 ("ASC 606"). ASC 606 requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or services. On January 1, 2018, the Company adopted ASC 606 and applied this guidance to all open contracts at the date of adoption using the modified retrospective method. Refer to Note 3. Revenue Recognition, for further details.

ASU 2016-01

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities" (Subtopic 825-10), which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This guidance requires equity investments to be measured at fair value with changes in fair value recognized in net income. This guidance simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. This guidance also clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The Company adopted the guidance effectively January 1, 2018. The adoption did not have a material impact to the Company. The Company believes the most significant impact will be that the adoption of the new guidance could increase the volatility of its Other income (expense), net, as a result of the re-measurement of its equity investments without readily determinable fair values upon the occurrence of observable price changes and impairments.

ASU 2016-16

In October 2016, the FASB issued ASU 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory" (Topic 740), which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. This removes the exception to postpone recognition until the asset has been sold to an outside party. ASU 2016-16 is effective for the Company in the first fiscal quarter of 2018 and early adoption is permitted. The Company adopted the new standard effectively January 1, 2018. Upon adoption, the Company has recorded a deferred tax asset of $21.1 million resulting from differences in the tax basis of assets and the consolidated book basis of assets resulting from intra-entity transfers of intangible assets. The recognition of the deferred tax asset results in an increase to retained earnings upon adoption. Further, the Company estimates that adoption of the standard will increase tax expense by an approximate $1.3 million in 2018, but fluctuate over time due to different lives of the intangibles. There is no material impact on the Company's cash flows.

ASU 2017-12

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities" (Topic 815), which expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance also makes certain targeted improvements to simplify the application of hedge accounting guidance, ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness and ease the reporting on hedge ineffectiveness. ASU 2017-12 is effective for the Company in the first fiscal quarter of 2019 and early adoption is permitted. Entities should apply the guidance to existing cash flow and net investment hedge relationships using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings on the date of adoption. The guidance also provides transition relief to make it easier for entities to apply certain amendments to existing hedges where the hedge documentation needs to be modified. The Company early adopted the new guidance effectively January 1, 2018. The adoption did not impact opening retained earnings or have a material impact on the Company's consolidated financial statements. Additionally, upon adoption, the Company simplified its hedge accounting application by electing to include time value on currency cash flow hedge relationships prospectively.

ASU 2018-02

In February 2018, the FASB issued ASU 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income", which permits companies to reclassify tax effects stranded in Accumulated Other Comprehensive Income as a result of tax reform to retained earnings. ASU 2018-02 is effective for the Company in the first fiscal quarter of 2019 and early adoption is permitted. Entities have the option to reclassify these amounts rather than require reclassification and also have the option to apply the guidance retrospectively or at the beginning of the period of adoption. The Company early adopted the new guidance effectively January 1, 2018. Upon adoption, the Company has recognized immaterial adjustments to retained earnings at the beginning of the period of adoption.

Accounting Pronouncements Not Yet Effective

In February 2016, FASB issued ASU 2016-02, "Leases" (Topic 842), which requires lessees to recognize on the balance sheets a right-of-use asset, representing its right to use the underlying asset for the lease term, and a corresponding lease liability for all leases with terms greater than twelve months. The liability will be equal to the present value of lease payments while the right-of-use asset will be based on the liability, subject to adjustment, such as for initial direct costs. In addition, ASU 2016-02 expands the disclosure requirements for lessees. Upon adoption, the Company will be required to record a lease asset and lease liability related to its operating leases. ASU 2016-02 will be applied using a modified retrospective transition method and is effective for the Company in the first fiscal quarter of 2019, with early adoption permitted. The Company does not expect to early adopt the new guidance. The Company has appointed a project team and is in the process of evaluating the impact the new standard will have on its consolidated financial statements. The Company expects to complete the impact assessment process by the end of the third fiscal quarter of 2018, and to complete the implementation process, including adding procedures and evaluating necessary disclosures, prior to the first fiscal quarter of 2019.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments" (Topic 326), which replaces the incurred-loss impairment methodology and requires immediate recognition of estimated credit losses expected to occur for most financial assets, including trade receivables. Credit losses on available-for-sale debt securities with unrealized losses will be recognized as allowances for credit losses limited to the amount by which fair value is below amortized cost. ASU 2016-13 is effective for the Company beginning in the first fiscal quarter of 2020 and early adoption is permitted. The Company continues to assess the potential impact of the new guidance, but does not expect it to have material impacts on its financial position, results of operations or cash flows.

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

Note 3. Revenue Recognition

Adoption of ASC 606

On January 1, 2018, the Company adopted ASC 606 and applied this guidance to all open contracts at the date of adoption using the modified retrospective method. The Company recognized the cumulative effect of initially applying ASC 606 as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods (ASC 605). The adoption did not have a material impact to the nature and timing of its revenues, results of operations, cash flows and statement of financial position.

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

The majority of sales revenue continues to be recognized when control of the product transfers to customer upon shipment or delivery. The primary impact of adopting ASC 606 relates to the establishment of liability estimates for channel rebates and discounts upon revenue recognition on the basis of customary business practice. Under ASC 606, the Company is required to estimate for rebates and discounts ahead of commitment date if customary business practice creates an implied expectation that such activities will occur in the future. The Company utilizes channel rebates and discounts to stimulate end user demand. Consequently, this change in guidance results in an adjustment to the statement of financial position to accelerate the recording of a liability for yet to be committed channel marketing rebates and discounts upon adoption. Further, under ASC 606, deferred revenue balances are to be booked at an amount that reflects only the amounts expected to be received for future obligations. As such, an adjustment was made to allocate variable consideration to deferred revenue. Additionally, the balance sheet presentation of certain reserve balances previously shown net within accounts receivable are now presented as refund liabilities within current liabilities and deferrals for undelivered shipments with destination shipping terms are now removed from receivables and deferred revenue.

The following table summarizes the changes made to the unaudited condensed consolidated balance sheets of December 31, 2017 for the adoption of ASC 606:

	As of December 31, 2017	Adjustments	As of January 1, 2018
	(In thousands)		
Assets:			
Accounts receivable, net	$412,798	$ 6,113	$418,911
Inventories	$245,894	$ (2,368)	$243,526
Other non-current assets	$61,789	$ 4,344	$66,133
Liabilities:			
Accounts payable	$111,915	$ (156)	$111,759
Other accrued liabilities	$222,470	$ 45,481	$267,951
Deferred revenue	$55,284	$ (25,181)	$30,103
Income taxes payable	$7,015	$ 724	$7,739
Other non-current liabilities	$22,099	$ (276)	$21,823
Stockholders' equity:			
Retained earnings	$128,168	$ (12,503)	$115,665

The following table summarizes the impacts of adopting ASC 606 on the Company's unaudited consolidated balance sheets as of April 1, 2018:

	As reported	Adjustments	Balance without adoption of ASC 606
	(In thousands)		
Assets			
Accounts receivable, net	$317,102	$ (13,258)	$303,844
Inventories	$266,345	$ 2,166	$268,511
Other non-current assets	$85,953	$ (4,504)	$81,449
Liabilities:			
Accounts payable	$96,371	$ 286	$96,657
Other accrued liabilities	$239,261	$ (48,671)	$190,590
Deferred revenue	$30,985	$ 18,825	$49,810
Income taxes payable	$9,866	$ (528)	$9,338
Other non-current liabilities	$23,213	$ 273	$23,486
Stockholders' equity:			
Retained earnings	$140,080	$ 14,219	$154,299

The following table summarizes the impacts of adopting ASC 606 on the Company's unaudited consolidated statement of operations for the three months ended April 1, 2018:

	As reported	Adjustments	Balance without adoption of ASC 606
	(In thousands)		
Net revenue	$344,973	$ 2,273	$347,246
Cost of revenue	$240,468	$ 203	$240,671
Gross profit	$104,505	$ 2,070	$106,575
Provision for income taxes	$2,393	$ 357	$2,750
Net income	$5,590	$ 1,713	$7,303

Revenue Recognition Accounting Policy

Revenue Recognition

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

The majority of revenue comes from product sales, consisting of sales of Arlo, Connected Home and Small and Medium Business ("SMB") hardware products to customers (retailers, distributors and service providers). Revenue is recognized at a point in time when control of the good is transferred to the customer, generally occurring upon shipment or delivery dependent upon the terms of the underlying contract. The amount recognized reflects the consideration the Company expects to be entitled to in exchange for the transferred goods.

The Company sells subscription paid services, such as to its Arlo end user customers where it provides customers access to its cloud services. Revenue for subscription sales is generally recognized over time on a ratable basis over the contract term beginning on the date that the service is made available to the customers at time of registration. The subscription contracts are generally for 30 days or 12 months in length, billed in advance. All such service or support sales are typically recognized using an output measure of progress looking at time elapsed as the contracts generally provide the customer equal benefit throughout the contract period. In addition to selling paid subscriptions, the Company also sells services bundled with hardware systems and accounts for these sales in line with the multiple performance obligations guidance.

Revenue from all sales types is recognized at transaction price, the amount the Company expects to be entitled to in exchange for transferring goods or providing services. Transaction price is calculated as selling price net of variable consideration which may include estimates for future returns, sales incentives and price protection related to current period product revenue. In determining estimates for future returns, management analyzes historical data, channel inventory levels, current economic trends and changes in customer demand for the Company's products. Sales incentives and price protection are determined based on a combination of the actual amounts committed and through estimating future expenditure based upon historical customary business practice. Typically variable consideration does not need to be constrained as estimates are based on predictive historical data or future commitments that are planned and controlled by the Company. However, the Company continues to assess variable consideration estimates such that it is probable that a significant reversal of revenue will not occur.

Contracts with Multiple Performance Obligations

Some of the Company's contracts with customers contain multiple promised goods or services. Such contracts include hardware with bundled services, networking hardware with embedded software, various software subscription services, and support. For these contracts, the Company accounts for the promises separately as individual performance obligations if they are distinct. Performance obligations are determined to be considered distinct if both capable of being distinct and distinct within the context of the contract. In determining whether performance obligations meet the criteria for being distinct, the Company considers a number of factors, such as the degree of interrelation and interdependence between obligations, and whether or not the good or service significantly modifies or transforms another good or service in the contract. The embedded software on most of the hardware products is not considered distinct and therefore the combined hardware and incidental software is treated as one performance obligation and recognized at the point in time when control of product transfers to the customer. Service that is included with certain hardware products, mainly Arlo systems, is considered distinct and therefore the hardware and service are treated as separate performance obligations.

After identifying the separate performance obligations, the transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices are generally determined based on the prices charged to customers or using an adjusted market assessment. For Arlo systems, standalone selling price of the hardware is directly observable from add-on camera and base station sales. Standalone selling price of the service is estimated using an adjusted market approach.

Revenue is then recognized for each distinct performance obligation as control is transferred to the customer. In general, the hardware is recognized at time of shipping or delivery, while services and support are delivered over the stated service or support period or the estimated useful life. For Arlo systems, the hardware is recognized at the time control of the product transfers to the customer and the transaction price allocated to service is recognized over the estimated useful life of the system, beginning when the customer is expected to activate their account. Useful life of the systems is determined by industry norms, frequency of new model releases, and user history.

Warranties

Hardware products regularly include warranties to the end customers that consist of bug fixes, minor updates such that the product continues to function according to published specs in a dynamic environment, and phone support. These standard warranties are assurance type warranties and do not offer any services in addition to the assurance that the product will continue working as specified. Therefore, warranties are not considered separate performance obligations in the arrangement. Instead, the expected cost of warranty is accrued as expense in accordance with authoritative guidance. Extended warranties are sold separately and include additional support services. The transaction price for extended warranties is accounted for as service revenue and recognized over the life of the contract.

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

Shipping and Handling

Shipping and handling fees billed to customers are included 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. The Company has elected to account for shipping and handling activities related to contracts with customers as costs to fulfill the promise to transfer the associated products.

Shipping and handling costs associated with outbound freight totaled $2.7 million and $2.3 million for the three months ended April 1, 2018 and April 2, 2017, respectively.

Transaction Price Allocated to the Remaining Performance Obligations

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

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) as of April 1, 2018:

	1 year	2 years	Greater than 2 years	Total
Performance obligations	$81,371	$10,340	$6,879	$98,590

Contract Costs

Applying the practical expedient, the Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that otherwise would have been recognized is one year or less. These costs are included in sales and marketing and general and administrative expenses. If the incremental direct costs of obtaining a contract, which consist of sales commissions, relate to a service recognized over a period longer than one year, costs are deferred and amortized in line with the related services over the period of benefit. Deferred commissions are classified as noncurrent based on the original amortization period of over one year. As of April 1, 2018 deferred commissions were not significant.

Contract Balances

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

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

The following table reflects the changes in contract balances for the three months ended April 1, 2018:

	Balance Sheet Location	April 1, 2018	January 1, 2018(*)	$ change	% change
		(In thousands)			
Accounts Receivable, net	Accounts receivable, net	$317,102	$418,911	$(101,809)	(24.3)%
Contract liabilities - current	Deferred revenue	$30,985	$30,103	$882	2.9 %
Contract liabilities - non-current	Other non-current liabilities	$15,509	$13,839	$1,670	12.1 %

* Includes the adjustments made to all open contracts at the date of ASC 606 adoption using the modified retrospective method.

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During the three months ended April 1, 2018, contract liabilities increased primarily as a result of increased sales of products containing multiple performance obligations, where cash payments are received or due in advance of satisfying the service related performance obligation.

During the three months ended April 1, 2018, $13.5 million of revenue was deferred due to unsatisfied performance obligations, primarily relating to over time service revenue. During the three months, $10.8 million of revenue was recognized for the satisfaction of performance obligations over time. $9.4 million of this recognized revenue was included in the contract liability balance at the beginning of the period.

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

Disaggregation of Revenue

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

	Three Months Ended April 1, 2018				April 2, 2017 (*)			
	Arlo	Connected Home	SMB	Total	Arlo	Connected Home	SMB	Total
	(In thousands)							
Geographic regions:								
Americas	$71,000	$131,604	$31,016	$233,620	$42,672	$136,204	$32,753	$211,629
EMEA	18,741	21,428	26,460	66,629	12,470	22,002	23,973	58,445
APAC	6,468	24,749	13,507	$44,724	$5,570	$36,155	$11,858	$53,583
Total net revenue	$96,209	$177,781	$70,983	$344,973	$60,712	$194,361	$68,584	$323,657
Sales channels:								
Service provider	$8,387	$41,797	$1,063	$51,247	$1,977	$53,193	$790	$55,960
Non-service provider	87,822	135,984	69,920	293,726	$58,735	$141,168	$67,794	267,697
Total net revenue	$96,209	$177,781	$70,983	$344,973	$60,712	$194,361	$68,584	$323,657

* As noted above, prior period amounts have not been adjusted under the modified retrospective method.

Note 4. Business Acquisition
Placemeter, Inc.
On November 30, 2016, the Company acquired Placemeter, Inc. ("Placemeter"), an industry leader in computer vision analytics, for total purchase consideration of $9.6 million. The Company believes that Placemeter’s engineering talent will add value to NETGEAR’s Arlo smart security team, and that their proprietary computer vision algorithms will help to build video analytics solutions for the Arlo platform.
The Company paid $8.8 million of the aggregate purchase price in the fourth quarter of 2016 and paid the remaining $0.8 million in the first quarter of fiscal 2017. The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of Placemeter have been included in the unaudited condensed consolidated financial statements since the date of acquisition. Pro forma results of operations for the

acquisition are not presented as the financial impact to the Company's consolidated results of operations is not material.

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

The allocation of the purchase price was as follows (in thousands):

Cash and cash equivalents	$8
Accounts receivable	11
Prepaid expenses and other current assets	130
Property and equipment	83
Intangibles	6,000
Goodwill	3,742
Accounts payable	(40)
Other accrued liabilities	(74)
Deferred tax liabilities	(308)
Total purchase price	$9,552

The $3.7 million of goodwill recorded on the acquisition of Placemeter is not deductible for U.S. federal or U.S. state income tax purposes. The goodwill recognized, which was assigned to the Company's former retail segment upon acquisition and was allocated to the Arlo segment under its current reporting structure, is primarily attributable to expected synergies resulting from the acquisition.

In connection with the acquisition, the Company recorded $0.3 million of deferred tax liabilities net of deferred tax assets. The deferred tax liabilities were recorded for the book basis of intangible assets for which the Company has no tax basis. The deferred tax liabilities are reduced by the tax benefit of the net operating losses as of the date of the acquisition after consideration of limitations on the use under U.S. Internal Revenue Code section 382.

The Company designated $5.5 million of the acquired intangibles as software technology and a further $0.2 million of the acquired intangibles as database. The valuations were arrived at using the replacement cost method, with consideration having been given to the estimated time, investment and resources required to recreate the acquired intangibles. A discount rate of 15.0% was used in the valuation of each intangible. The acquired intangibles are being amortized over an estimated useful life of four years.

The Company designated $0.3 million of the acquired intangibles as non-compete agreements. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to the non-compete agreements and discounted at 20.0%. The acquired agreements are being amortized over an estimated useful life of three years.

Note 5. Balance Sheet Components

Available-for-sale short-term investments

	As of April 1, 2018				December 31, 2017			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(In thousands)							
U.S. treasuries	$125,184	$ —	$ (184)	$125,000	$124,816	$ —	$ (146)	$124,670
Certificates of deposit	161	—	—	161	162	—	—	162
Total	$125,345	$ —	$ (184)	$125,161	$124,978	$ —	$ (146)	$124,832

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

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Equity investments without readily determinable fair values

As noted above, the Company adopted ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities" on January 1, 2018. The Company's equity investments without determinable fair values was $3.1 million as of April 1, 2018 and $4.5 million as of December 31, 2017, and are included in Other non-current assets in the unaudited condensed consolidated balance sheets. The Company does not have a controlling interest or the ability to exercise significant influence over these investees and these investments do not have readily determinable fair values. Equity investments without readily determinable fair values are accounted for at cost, less impairment and adjusted for subsequent observable price changes obtained from orderly transactions for identical or similar investments issued by the same investee. Such changes in the basis of the equity investment are recognized in Other income (expense), net in the unaudited condensed consolidated statements of operations. $1.4 million of impairments was recognized during the three months ended April 1, 2018 and there were no impairments recognized during the three months ended April 2, 2017.

Accounts receivable, net

	As of April 1, 2018	December 31, 2017
	(In thousands)	
Gross accounts receivable	$318,358	$ 437,891
Allowance for doubtful accounts	(1,256)	(1,257)
Allowance for sales returns	— *	(20,189)
Allowance for price protection	— *	(3,647)
Total allowances	(1,256)	(25,093)
Total accounts receivable, net	$317,102	$ 412,798

* Upon adoption of ASC 606, allowances for sales returns and price protection were reclassified to current liabilities as these reserve balances are considered refund liabilities. Refer to Note 3. Revenue Recognition, for additional information on the adoption impact.

Inventories

	As of April 1, 2018	December 31, 2017
	(In thousands)	
Raw materials	$3,982	$ 4,465
Work in process	3	—
Finished goods	262,360	241,429
Total inventories	$266,345	$ 245,894

The Company records provisions for excess and obsolete inventory based on assumptions about future demand and market conditions. While management believes the estimates and assumptions underlying its current forecasts are reasonable, there is risk that additional charges may be necessary if current forecasts are greater than actual demand.

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Property and equipment, net

	As of April 1, 2018	December 31, 2017
	(In thousands)	
Computer equipment	$10,135	$ 10,114
Furniture, fixtures and leasehold improvements	21,452	21,640
Software	29,193	28,997
Machinery and equipment	63,422	62,490
Total property and equipment, gross	124,202	123,241
Accumulated depreciation and amortization	(104,423)	(102,581)
Total property and equipment, net	$19,779	$ 20,660

Depreciation and amortization expense pertaining to property and equipment was $3.3 million for the three months ended April 1, 2018 and $3.4 million for the three months ended April 2, 2017.

Intangibles, net

	As of April 1, 2018			As of December 31, 2017		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(In thousands)					
Technology	$66,599	$ (62,724)	$3,875	$66,599	$ (62,172)	$4,427
Customer contracts and relationships	56,500	(39,186)	17,314	56,500	(37,430)	19,070
Other	11,045	(9,785)	1,260	11,045	(9,554)	1,491
Total intangibles, net	$134,144	$ (111,695)	$22,449	$134,144	$ (109,156)	$24,988

Amortization of intangibles was $2.5 million for the three months ended April 1, 2018 and $4.5 million for the three months ended April 2, 2017.

As of April 1, 2018, estimated amortization expense related to finite-lived intangibles for the remaining years is as follows (in thousands):

2018 (remaining nine months)	$6,857
2019	7,544
2020	6,622
2021	1,413
2022	13
Total estimated amortization expense	$22,449

Other non-current assets

	As of April 1, 2018	December 31, 2017
	(In thousands)	
Non-current deferred income taxes	$74,754	$ 49,468
Other	11,199	12,321
Total other non-current assets	$85,953	$ 61,789

Other accrued liabilities

	As of April 1, 2018	December 31, 2017
	(In thousands)	
Sales and marketing	$95,299	$ 96,153
Warranty obligation	18,978	*75,824
Sales returns	73,562	*—
Freight	7,790	10,567
Other	43,632	39,926
Total other accrued liabilities	$239,261	$ 222,470

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* Upon adoption of ASC 606 on January 1, 2018, certain warranty reserve balances totaling $57.9 million were reclassified to sales returns as these liabilities are payable to the Company's customers and settled in cash or by credit on account. Under ASC 606, these amounts are to be accounted for as sales with right of return.

Note 6. Derivative Financial Instruments

The Company’s subsidiaries have had, and will continue to have material future cash flows, including revenue and expenses, which 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 business 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, Canadian dollar, 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 existing assets and liabilities. The Company does not enter into derivatives transactions for trading or speculative purposes.

The Company’s foreign currency forward contracts do not contain any credit-risk-related contingent features. The Company 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 and limits the amount of credit exposure to any one counter-party. In addition, the derivative contracts typically mature in less than eleven 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 Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including, but not limited to, materiality, accounting considerations or the prohibitive economic cost of hedging particular exposures.

There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign exchange rates. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with the authoritative guidance for derivatives and hedging. The Company records all derivatives on the balance sheets at fair value. Cash flow hedge gains and losses are recorded in other comprehensive income

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("OCI") until the hedged item is recognized in earnings. Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in Other income (expense), net in the unaudited condensed consolidated statements of operations.

The fair values of the Company’s derivative instruments and the line items on the unaudited condensed consolidated balance sheets to which they were recorded as of April 1, 2018 and December 31, 2017 are summarized as follows:

Derivative Assets	Balance Sheet Location	April 1, 2018	December 31, 2017	Balance Sheet Location	April 1, 2018	December 31, 2017
		(In thousands)			(In thousands)	
Derivative assets not designated as hedging instruments	Prepaid expenses and other current assets	$846	$ 1,314	Other accrued liabilities	$3,374	$ 7,128
Derivative assets designated as hedging instruments	Prepaid expenses and other current assets	9	485	Other accrued liabilities	59	1,064
Total		$855	$ 1,799		$3,433	$ 8,192

Refer to Note 13, Fair Value Measurements, in Notes to Unaudited Condensed Consolidated Financial Statements for detailed disclosures regarding fair value measurements in accordance with the authoritative guidance for fair value measurements and disclosures.

Offsetting Derivative Assets and Liabilities

The Company has entered into master netting arrangements which allow net settlements under certain conditions. Although netting is permitted, it is currently the Company's policy and practice to record all derivative assets and liabilities on a gross basis in the unaudited condensed consolidated balance sheets.

The following tables set forth the offsetting of derivative assets as of April 1, 2018 and December 31, 2017:

As of April 1, 2018	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Assets Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets: Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
JP Morgan	$28	$ —	$ 28	$ (10)	$ —	$ 18
Bank of America	541	—	541	(541)	—	—
Wells Fargo	286	—	286	(286)	—	—
Total	$855	$ —	$ 855	$ (837)	$ —	$ 18

As of December 31, 2017	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Assets Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
Bank of America	$1,664	$ —	$ 1,664	$ (1,664)	$ —	$ —
Wells Fargo	135	—	135	(135)	—	—
Total	$1,799	$ —	$ 1,799	$ (1,799)	$ —	$ —

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The following tables set forth the offsetting of derivative liabilities as of April 1, 2018 and December 31, 2017:

As of April 1, 2018	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets: Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
JP Morgan	$10	$ —	$ 10	$ (10)	$ —	$ —
Bank of America	2,500	—	2,500	(541)	—	1,959
Wells Fargo	923	—	923	(286)	—	637
Total	$3,433	$ —	$ 3,433	$ (837)	$ —	$ 2,596

As of December 31, 2017	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets: Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
Bank of America	$7,815	$ —	$ 7,815	$ (1,664)	$ —	$ 6,151
Wells Fargo	377	—	377	(135)	—	242
Total	$8,192	$ —	$ 8,192	$ (1,799)	$ —	$ 6,393

Cash flow hedges

To help manage the exposure of operating margins to fluctuations in foreign currency exchange rates, the Company hedges a portion of its anticipated foreign currency revenue, costs of revenue and certain operating expenses. These hedges are designated at the inception of the hedge relationship as cash flow hedges under the authoritative guidance for derivatives and hedging. Effectiveness 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 less than eleven months. The Company enters into about ten forward contracts per quarter with an average size of approximately $7.0 million

USD equivalent related to its cash flow hedging program.

The effects of the Company's cash flow hedges on the unaudited condensed statements of operations for the three months ended April 1, 2018 are summarized as follows:

	Location and Amount of Gains (Losses) Recognized in Income on Cash Flow Hedges				
	Three Months Ended April 1, 2018				
	Net revenue	Cost of revenue	Research and development	Sales and marketing	General and administrative
	(In thousands)				
Statements of operations	$344,973	$240,468	$ 28,947	$ 43,658	$ 16,638
Gains (losses) on cash flow hedge	$(2,568)	$6	$ 99	$ 230	$ 41

The Company expects to reclassify to earnings all of the amounts recorded in OCI associated with its cash flow hedges over the next twelve months. OCI associated with cash flow hedges of foreign currency revenue is recognized as a component of net revenue in the same period the related revenue is recognized. OCI 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 expenses in the same period and in the same statements of operations line item as the related costs of revenue and operating expenses are recognized.

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 OCI with such derivative instruments are reclassified immediately into earnings through Other income (expense), net. 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 as there were no discontinued cash flow hedges during the three months ended April 1, 2018 and April 2, 2017.

The pre-tax effects of the Company's derivative instruments on OCI and the unaudited condensed consolidated statement of operations for the three months ended April 1, 2018 and April 2, 2017 are summarized as follows:

	Three Months Ended April 1, 2018		
Derivatives Designated as Hedging Instruments	Gains (Losses) Recognized in OCI - Effective Portion	Location of Gains (Losses) Reclassified from OCI into Income - Effective Portion	Gains (Losses) Reclassified from OCI into Income - Effective Portion [(1)]
	(In thousands)		
Cash flow hedges:			
Foreign currency forward contracts	$(1,500)	Net revenue	$ (2,568)
Foreign currency forward contracts	—	Cost of revenue	6
Foreign currency forward contracts	—	Research and development	99
Foreign currency forward contracts	—	Sales and marketing	230
Foreign currency forward contracts	—	General and administrative	41
Total	$(1,500)		$ (2,192)

(1) Refer to Note 10, Stockholders' Equity, which summarizes the accumulated other comprehensive income activity related to derivatives.

	Three Months Ended April 2, 2017		
Derivatives Designated as Hedging Instruments	Gains (Losses) Recognized in OCI - Effective Portion	Location of Gains (Losses) Reclassified from OCI into Income - Effective Portion	Gains (Losses) Reclassified from OCI into Income - Effective Portion [(1)]
	(In thousands)		
Cash flow hedges:			
Foreign currency forward contracts	$(117)	Net revenue	$ 2,035
Foreign currency forward contracts	—	Cost of revenue	(13)
Foreign currency forward contracts	—	Research and development	(19)

Foreign currency forward contracts	—	Sales and marketing	(364)
Foreign currency forward contracts	—	General and administrative	(59)
Total	$(117)		$ 1,580

(1) Refer to Note 10, Stockholders' Equity, which summarizes the accumulated other comprehensive income activity related to derivatives.

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 that may not be incorporated into the cash flow hedge program. The Company adjusts its non-designated hedges monthly and enters into about ten non-designated derivatives per quarter. The average size of its non-designated hedges is approximately $2.0 million USD equivalent and these hedges range from one to three months in duration.

The effects of the Company's non-designated hedge included in Other income (expense), net in the unaudited condensed consolidated statements of operations for the three months ended April 1, 2018 and April 2, 2017 are as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gains (Losses) Recognized in Income on Derivative	Three Months Ended April 1, 2018	Three Months Ended April 2, 2017
		(In thousands)	
Foreign currency forward contracts	Other income (expense), net	$(2,408)	$(1,353)

Note 7. Net Income Per Share

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

Net income per share for the three months ended April 1, 2018 and April 2, 2017 are as follows:

	Three Months Ended April 1, 2018	Three Months Ended April 2, 2017
	(In thousands, except per share data)	
Numerator:		
Net income	$5,590	$15,994
Denominator:		
Weighted average common shares - basic	31,427	32,944

Potentially dilutive common share equivalent	1,233	1,192
Weighted average common shares - dilutive	32,660	34,136
Basic net income per share	$0.18	$0.49
Diluted net income per share	$0.17	$0.47
Anti-dilutive employee stock-based awards, excluded	773	70

Note 8. Income Taxes

The income tax provision for the three months ended April 1, 2018 and April 2, 2017, was $2.4 million, or an effective tax rate of 30.0%, and $7.5 million, or an effective tax rate of 32.0%, respectively. The decrease in the effective tax rate for the three months ended April 1, 2018, compared to the three months ended April 2, 2017, resulted primarily from a decrease in the federal statutory rate of 35% to 21% effective as of January 1, 2018. This was offset by certain nondeductible expenses transaction costs resulting from the planned separation of the Arlo segment and the establishment of a valuation allowance for a capital loss where tax benefit is not assured. Additionally, tax expense was lower in the three months ended April 1, 2018 due to lower pre-tax earnings compared to the three months ended April 2, 2017.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Act. The Tax Act reduced the U.S. statutory rate from 35% to 21% effective as of January 1, 2018. In addition, certain new complex tax rules related to the taxation of foreign earnings (Global Intangible Low-Taxed Income, Foreign Derived Intangible Income and Base Erosion and Anti-abuse Tax) became effective as of January 1, 2018. Based on information available to date, the Company has evaluated these provisions and estimate that there is no material impact on its income tax provision for the quarter ended April 1, 2018.

In the year ended December 31, 2017, the Company recorded the effects of a reduction in tax rates from 35% to 21% on its deferred tax assets and liabilities and to record a one-time transition tax. After the enactment of the Tax Act, the SEC issued Staff Accounting Bulletin No. 118 ("SAB 118") to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The Company has calculated an estimate of the impact of the Tax Act in its tax provision for the period ending December 31, 2017 in accordance with its understanding of the Tax Act and guidance available as of the date of the filing of Form 10-K and as a result recorded $48.3 million as additional income tax expense in the fourth fiscal quarter of 2017, the period in which the legislation was enacted. The provisional amount related to the remeasurement of certain deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future, was $26.6 million. The provisional amount related to the one-time transition tax on the mandatory deemed repatriation of foreign earnings was $21.7 million. The Company has reviewed these amounts based on additional guidance available and has not changed its estimates.

In accordance with SAB 118, the Company has determined that the $21.7 million of current tax expense recorded in connection with the transition tax on the mandatory deemed repatriation of foreign earnings was a provisional amount and a reasonable estimate at December 31, 2017. The Company has reviewed these amounts based on additional guidance available and has not changed its estimates.

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

The Company files income tax returns in the U.S. federal jurisdiction as well as various state, local, and foreign jurisdictions. Due to the uncertain nature of ongoing tax audits, the Company has recorded its liability for uncertain tax positions as part of its long-term liability as payments cannot be anticipated over the next twelve months. The existing tax positions of the Company continue to generate an increase in the liability for uncertain tax positions. The liability for uncertain tax positions may be reduced for liabilities that are settled with taxing authorities or on which the statute of limitations could expire without assessment from tax authorities. The possible reduction in liabilities for uncertain tax positions resulting from the expiration of statutes of limitation in multiple jurisdictions in the next twelve months is approximately $0.9 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

Note 9. Commitments and Contingencies

Leases

The Company leases office space, cars and equipment under operating leases, some of which are non-cancelable, with various expiration dates through December 2026. 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.

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. As of April 1, 2018, the Company had approximately $147.2 million in non-cancelable purchase commitments with suppliers. The Company establishes a loss liability for all products it does not expect to sell for which it has committed purchases from suppliers. Such losses have not been material to date. From time to time the Company's suppliers procure unique complex components on the Company's behalf. If these components do not meet specified technical criteria or are defective, the Company should not be obligated to purchase the materials. However, disputes may arise as a result and significant resources may be spent resolving such disputes.

Warranty Obligation

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
	(In thousands)	
Balance as of beginning of the period	$75,824	$58,520
Reclassified to sales returns upon adoption of ASC 606	(57,860)*	—
Provision for warranty obligation made during the period	2,058	26,753
Settlements made during the period	(1,044)	(28,937)
Balance at end of period	$18,978	$56,336

* Upon adoption of ASC 606 on January 1, 2018, certain warranty reserve balances totaling $57.9 million were reclassified to sales returns as these liabilities are payable to the Company's customers and settled in cash or by credit on account. Under ASC 606, these amounts are to be accounted for as sales with right of return.

Guarantees and Indemnifications

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a Director and Officer Insurance Policy that enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of each indemnification agreement is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of April 1, 2018.

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers (the “Indemnified Parties”) for any expenses or liability resulting from claimed infringements by the Company's products of patents, trademarks or copyrights of third parties that are asserted against the Indemnified Parties, subject to customary carve outs. The terms of these indemnification agreements are generally perpetual after execution of the agreement. The maximum amount of potential future indemnification is generally unlimited. From time to time, the Company receives requests for indemnity and may choose to assume the defense of such litigation asserted against the Indemnified Parties. The Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of April 1, 2018.

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 Chief Operations Officer) and up to 26 weeks (for other key executives). Such employees will also continue to have equity awards 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 equity awards. The Company has no liabilities recorded for these agreements as of April 1, 2018.

Litigation and Other Legal Matters

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

Ericsson v. NETGEAR, Inc.

On September 14, 2010, Ericsson Inc. and Telefonaktiebolaget LM Ericsson (collectively “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 (the “‘516 Patent”); 6,330,435 (the “‘435 Patent”); 6,424,625 (the “‘625 Patent”); 6,519,223 (the “‘223 Patent”); 6,772,215 (the “‘215 Patent”); 5,987,019 (the “‘019 Patent”); 6,466,568 (the “‘568 Patent”); and 5,771,468 (the “'468 Patent"). Ericsson generally alleged that the Company and the other defendants infringe the Ericsson patents through the defendants' IEEE 802.11-compliant products. In addition, Ericsson alleged that the Company infringed the claimed methods and apparatuses of the '468 Patent through the Company's PCMCIA routers. On June 22, 2012, Intel filed its Complaint in Intervention, meaning that Intel also became a defendant. During litigation, Ericsson (a) dismissed the

'468 Patent with prejudice and gave the Company a covenant not to sue as to products in the marketplace now or in the past, (b) dropped the '516 Patent and (c) dropped the '223 Patent, except for those products that use Intel chips.

A jury trial occurred in the Eastern District of Texas from June 3 through June 13, 2013. After hearing the evidence, the jury found no infringement of the '435 and '223 Patents, and the jury found infringement of claim 1 of the '625 Patent, claims 1 and 5 of the '568 Patent, and claims 1 and 2 of the '215 Patent. The jury also found that there was no willful infringement by any defendant. Additionally, the jury found no invalidity of the asserted claims of the '435 and '625 Patents. The jury assessed the following damages against the defendants: D-Link: $435,000; NETGEAR: $3,555,000; Acer/Gateway: $1,170,000; Dell: $1,920,000; Toshiba: $2,445,000; Belkin: $600,000. The damages awards equated to 15 cents per unit for each accused 802.11 device sold by each defendant (5 cents per patent).

The Company and other defendants appealed the jury verdict. On December 4, 2014, the Federal Circuit issued its opinion and order in the appeal. The Federal Circuit vacated the entirety of the $3.6 million jury verdict against the Company and other defendants' damages awards and also vacated the ongoing 15 cents per unit royalty verdict, finding that the District Court had not properly instructed the jury on royalty rates and Ericsson's licensing promises.

While the Federal Circuit found the district court had inadequate jury instructions, it held that there was enough evidence for the jury to find infringement of two claims of U.S. Patent Number 6,466,568 and two claims of U.S. Patent Number 6,772,215, but reversed the lower court's decision not to grant a noninfringement judgment as a matter of law regarding the third patent, U.S. Patent Number 6,424,625, finding that no reasonable jury could find that the '625 Patent was infringed by the defendants. The case was remanded for further proceedings.

In September 2013, Broadcom filed petitions in the USPTO at the Patent Trial and Appeal Board (PTAB) seeking inter partes review ("IPR") of Ericsson's three patents that the jury found were infringed by the Company and other defendants. On March 6, 2015, the PTAB invalidated all the claims of these three patents that were asserted against the Company and other defendants, ruling these claims were anticipated or obvious in light of prior art. This PTAB decision comes on top of the Federal Circuit decision (a) vacating the jury verdict after finding that the district court had not properly instructed the jury on royalty rates and Ericsson's licensing promises, and (b) ruling that no reasonable jury could have found the '625 Patent infringed. Accordingly, the Company has reversed the accruals related to this case.

Ericsson appealed the PTAB's Broadcom IPR decision to the Federal Circuit and also requested that the PTAB reconsider its decision. The PTAB denied Ericsson's request for reconsideration. On appeal to the Federal Circuit, Ericsson argued that the PTAB's determination that Broadcom had timely filed its IPR petitions was improper, as it was in privity with the defendants, and that the PTAB should not have invalidated the claims of the '625 Patent, the '568 Patent, and '215 Patent. The Federal Circuit upheld the invalidity of the patents' claims, as previously determined by the PTAB, and ruled that Ericsson could not appeal the timeliness of Broadcom's IPR petitions. Ericsson petitioned the Federal Circuit for an en banc rehearing of the Federal Circuit's panel decision that Broadcom was timely in bringing its IPRs, and the Federal Circuit agreed to the en banc rehearing. On January 8, 2018, the Federal Circuit sitting en banc ruled that the timeliness of Broadcom's IPR petitions was an appealable issue. Following this en banc decision finding that PTAB decisions on privity are appealable, on April 20, 2018, the original three judge panel upheld its prior finding of invalidity. The panel found that Broadcom was not in privity with the defendants in the district court case, and, therefore, Broadcom had timely filed its IPR petitions. Ericsson can attempt to appeal this decision to the Supreme Court. The present status of the case continues to be that the Company does not infringe any valid Ericsson patent.

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

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

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

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

The hearing for the validity of the tax assessment for 2007 was held on March 10, 2016 with the Provincial Tax Court who issued its decision in favor of the Company on April 7, 2016. The Inland Revenue Agency has filed its appeal to the Regional Tax Court and the Company has submitted its counter brief. The hearing was held on November 17, 2017. NETGEAR is waiting on a decision to be issued.

With respect to 2008 through 2010, the Company filed its appeal briefs with the Provincial Tax Court in October 2015 and the hearing for the validity of the tax assessments was held on April 21, 2016. A decision favorable to the Company was issued on May 12, 2016. The Inland Revenue Agency has filed its appeal to the Regional Tax Court. The Company filed its counter brief on February 5, 2017. The hearing has been scheduled for May 21, 2018.

With respect to 2011 through 2012, the Company has filed its appeal brief on February 26, 2016 with the Provincial Tax Court to contest the relevant tax assessments. The hearing for suspension was held and the Request for Suspension of payment was granted. On October 13, 2016, the Company filed its final brief with the Provincial Tax Court. The hearing was held on October 24, 2016 and a decision favorable to the Company was issued by the Court. The Inland Revenue Agency appealed the decision before the Regional Tax Court on April 19, 2017. The Company filed its counter brief on June 16, 2017 and awaits the scheduling of the hearing.

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

Via Vadis v. NETGEAR, Inc.

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

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

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

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

The second IPR on the '125 patent, however, resulted in cancellation of all claims asserted in Via Vadis's suit against the Company. Reissue '521 did not have any claims found invalid by the PTAB, and some dependent claims of the '680 patent survived the IPRs, and some claims of the '680 patent were canceled. The Northern District of California case against the Company remains stayed.

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

Chrimar Systems, Inc. v NETGEAR, Inc.

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

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

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

On December 3, 2015, the Company filed with the Court a motion to transfer venue to the District Court for the Northern District of California and their memorandum of law in support thereof. On December 23, 2015, CMS filed its response to the Company's motion to transfer, and, on January 8, 2016, the Company filed its reply brief in support of its motion to transfer venue. On January 15, 2016, the Court granted the Company's motion to transfer venue to the District Court for the Northern District of California. The initial case management conference in the Northern District of California occurred on May 13, 2016, and on August 19, 2016, the parties exchanged preliminary claim constructions and extrinsic evidence. On August 26, 2016, the Company and three defendants in other Northern District of California CMS cases (Juniper Networks, Inc., Ruckus Wireless, Inc., and Fortinet, Inc.) submitted motions to stay their cases. The defendants in part argued that stays were appropriate pending the resolution of the currently-pending IPRs of the patents-in-suit before the Patent Trial and Appeal Board (PTAB), including four IPR Petitions filed by Juniper. On September 9, 2016, CMS submitted its opposition to the motions to stay the cases. On September 26, 2016, the Court ordered the cases stayed in their entirety, until the PTAB reaches institution decisions with respect to Juniper's four pending IPR petitions. Juniper's four IPR petitions were instituted by the PTAB in January 2017, and the Company subsequently moved to join the IPR petitions as an "understudy" to Juniper, only assuming a more active role in the petitions in the event Juniper settles with CMS. For all four patents in suit against the Company, the PTAB ordered that (a) the Petitioners' (the Company, Ruckus, and Brocade) Motion for Joinder to the Juniper IPRs is granted; (b) the Petitioners IPRs are instituted on the same grounds as in the Juniper 'IPRs and Petitioners are joined with the Juniper IPRs; and (c) all further filings by Petitioners in the joined proceedings will be in the Juniper IPRs. On December 21, 2017, the PTAB issued the first of the four Final Written Decisions in the IPRs filed by the Company on the patents in suit, ruling that the claims of the '107 Patent asserted by Chrimar were invalid. This was quickly followed by two more Final Written Decisions -- on January 3, 2018, the '838 patent's asserted claims were ruled invalid, and on January 23, 2018 the ‘012 patent’s asserted claims were ruled invalid. Chrimar has 30 days from each Final Written Decision to seek a rehearing at the PTAB and 63 days from each to file an appeal. On April 26, 2018, the PTAB issued its decision invalidating all of the claims of the ‘760 patent challenged in the IPR. The PTAB’s reasoning was similar to the reasoning set forth in the PTAB’s previous decisions on the 012, 107 and 838 patents. The ‘760 patent claims were, however, amended by Chrimar during the pendency of the ‘760 IPR, and the PTAB did not rule on the validity of the amended claims, as they were not challenged in the original IPR Petitions (they couldn’t have been because the Chrimar amendments had not yet happened). Chrimar will appeal the PTAB IPR invalidation decisions of the patents in suit, and the Company is considering its options in responding to the Chrimar appeals.

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

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Realtime Data v. NETGEAR, Inc.

On February 27, 2017, the Company was sued in the Eastern District of Texas by Realtime Data LLC ("Realtime"), which claims to do business as "Ixo." The complaint includes four (4) asserted patents:

- US 9,054,728, Data compression systems and methods;
- US 7,415,530, System and methods for accelerated data storage and retrieval;
- US 9,116,908, System and methods for accelerated data storage and retrieval; and
- US 8,717,204, Methods for encoding and decoding data

The accused products specifically include the Company's "ReadyDATA RD5200, RDD516, ReadyRECOVER" products. Generally, the complaint alleges that the asserted patents are directed to various compression / decompression algorithms and systems and is directed at the Company's ReadyDATA, ReadyNAS, and ReadyRECOVER products.

Realtime has filed several patent suits over the last few years and the asserted patents have gone through various rounds of litigation and IPRs. In this particular tranche of Realtime lawsuits, Realtime also sued Array Networks, Barracuda Networks, Carbonite, Circadence, Comm Vault, Exinda and Snacor.

The Company received an extension until May 8, 2017 to answer the complaint and answered the complaint on that date. On August 15, 2017, the Company filed its motion to transfer venue for convenience from the Eastern District of Texas to the Northern District of California. On September 19, 2017, the plaintiff filed its Opposition to the Company's motion to transfer venue. On October 11, 2017, the Eastern District of Texas granted the Company's motion to transfer venue to the Northern District of California.

The litigation was officially transferred to the Northern District of California, and the initial case management conference occurred before the Court on December 14, 2017. At a subsequent scheduling conference on January 25, 2018, the Court sua sponte stayed the cases brought by Realtime against Barracuda, Riverbed, and the Company until June 14, 2018 and set another scheduling conference for June 14, 2018 when the Court will evaluate whether the stay should be extended based on the results of at least one IPR of the patents in suit. On January 12, 2018, Realtime served its infringement contentions, which were the same as Realtime had previously served in the Eastern District of Texas prior to transfer of the case to California.

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

Vivato v. NETGEAR, Inc.

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

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

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

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

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

On March 20, 2018, the Company and other defendants in the various Vivato cases moved the Court to stay the case pending various IPRs filed on all of the patents in suit. Every asserted claim of all three patents-in-suit is now subject to challenge in IPRs that are pending before the U.S. Patent and Trial Appeal Board ("PTAB"). In particular, the Company, Belkin, and Ruckus are filing one set of IPRs on the three patents in suit; Cisco is filing another set of independent IPRs on the three patents in suit; and Aruba is filing yet another set of independent IPRs on the three patents in suit.

On April 11, 2018, the Court granted the motion to stay. The Court called it tentative, but that descriptor will likely drop as soon as the Company and other defendants file the IPRs in early May 2018.

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

Hera Wireless v. NETGEAR, Inc.

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

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

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

MyMail v. NETGEAR, Inc.

On August 25, 2017, the non-practicing entity MyMail Ltd. ("MyMail") sued the Company for patent infringement in the District of Delaware. This is MyMail's third round of cases, starting in November 2016, and, in this round, MyMail also filed against Ricoh, Panasonic, Acer, and TCL Communications.

MyMail is accusing essentially all the Company's routers and range extenders of infringing claim 5 of U.S. Patent 8,732,318 (the '318 patent), entitled "Method of Connecting a User to a Network." Claim 5 of the '318 Patent describes a method for modifying network access information and then accessing the network using the modified information. MyMail is specifically accusing the Wi-Fi Protected Setup (WPS) function of the accused routers and range extenders.

On December 7, 2017, the Company answered the complaint. In addition to denying that each claim limitation of patents in suit is met, the Company also asserted various affirmative defenses, including invalidity and noninfringement. The parties submitted their jointly proposed scheduling order to the Court on January 11, 2018, which the Court generally adopted in its Scheduling Order of January 17, 2018. The Scheduling Order set the trial to begin on December 2, 2019.

On February 19, 2018, MyMail submitted its list of accused products. Most Arlo-branded products and the Company's router products were listed. MyMail's initial infringement contentions were submitted on April 20, 2018. Discovery is ongoing.

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

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Sassine v. NETGEAR, Inc.

On March 23, 2018, the Company was sued in the Northern District of California. The plaintiff, Michel Sassine, purportedly represents a nationwide class of customers that were injured when the Company’s ReadyCLOUD service allegedly had a service incident in March 2017 that deleted data that certain customers had stored on ReadyNAS storage devices. The complaint alleges that the Company: (a) failed to appropriately notify customers or take steps that would allow recovery of lost data, (b) violated Unfair Competition Laws, (c) breached its warranties, and (d) breached its contracts with customers.

The Company was served with the complaint on April 3, 2018, received an extension to answer and has not yet answered the complaint.

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

Photonic Imaging v. NETGEAR, Inc.

On April 2, 2018, the Company was sued for patent infringement in the District Court of Delaware by Photonic Imaging Solutions Inc. The complaint alleges that NETGEAR’s Arlo-branded camera products infringe U.S. Patent Nos. 6,184,055 (the “’055 Patent”) entitled “CMOS Image Sensor with Equivalent Potential Diode and Method for Fabricating the Same”; 6,563,187 (the “’187 Patent”) entitled “CMOS Image Sensor Integrated Together with Memory Device”; 6,949,388 (the “’388 Patent”) entitled “CMOS Image Sensor Integrated Together with Memory Device”; and 7,113,203 (the “’203 Patent”) entitled “Method and System for Single-Chip Camera”. The technology-at-issue is CMOS sensors used by Omnivision (“OV”) - in particular, the OV9712 CMOS image sensor. The Asserted Patents are original Hynix Semiconductor Inc. patents and have changed ownership a few times over the years.

The Company was served with the complaint on April 12, 2018 and has not yet answered the complaint.

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

Environmental Regulation

The Company is required to comply and is currently in compliance with the European Union ("EU") and other Directives on the Restrictions of the use of Certain Hazardous Substances in Electrical and Electronic Equipment (“RoHS”), Waste Electrical and Electronic Equipment ("WEEE") requirements, Energy Using Product (“EuP”) requirements, the REACH Regulation, Packaging Directive and the Battery Directive.

The Company is subject to various federal, state, local, and foreign environmental laws and regulations, including those governing the use, discharge, and disposal of hazardous substances in the ordinary course of our manufacturing process. The Company believes that its current manufacturing and other operations comply in all material respects with applicable environmental laws and regulations; however, it is possible that future environmental legislation may be enacted or current environmental legislation may be interpreted to create an environmental liability with respect to its facilities, operations, or products. See further discussion of the business risks associated with environmental legislation under the risk titled, "We are subject to, and must remain in compliance with, numerous laws and governmental regulations concerning the manufacturing, use, distribution and sale of our products, as well as any such future laws and regulations. Some of our customers also require that we comply with their own unique requirements relating to these matters. Any failure to comply with such laws, regulations and requirements, and any associated unanticipated costs, may adversely affect our business, financial condition and results of operations." within Item 1A

Risk Factors of this Form 10-Q.

Note 10. Stockholders' Equity

Stock Repurchases

From time to time, the Company’s Board of Directors has authorized programs under which the Company may repurchase shares of its common stock, depending on market conditions, in the open market or through privately negotiated transactions. Under the authorizations, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and

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the price of the Company's common stock. As of April 1, 2018, 2.0 million shares remained authorized for repurchase under the repurchase program. The Company did not repurchase any shares of common stock under the authorizations during the three months ended April 1, 2018. The Company repurchased, reported based on trade date, 0.2 million shares of common stock at a cost of $11.6 million under the repurchase authorization during the three months ended April 2, 2017.

The Company repurchased, as reported based on trade date, approximately 38,000 shares of common stock at a cost of $2.3 million to administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the three months ended April 1, 2018. Similarly, during the three months ended April 2, 2017, the Company repurchased, as reported based on trade date, approximately 38,000 shares of common stock at a cost of $1.9 million to 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.

Accumulated Other Comprehensive Income (Loss)

The following table sets forth the changes in accumulated other comprehensive income ("AOCI") by component for the three months ended April 1, 2018 and April 2, 2017:

	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
	(In thousands)			
Balance as of December 31, 2017	$(146)	$ (838)	$ 133	$(851)
Other comprehensive income (loss) before reclassifications	(38)	(1,500)	388	(1,150)
Less: Amount reclassified from accumulated other comprehensive income	—	(2,192)	460	(1,732)
Net current period other comprehensive income (loss)	(38)	692	(72)	582
Balance as of April 1, 2018	$(184)	$ (146)	$ 61	$(269)

	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
	(In thousands)			
Balance as of December 31, 2016	$(31)	$ 2,230	$ (261)	$1,938
Other comprehensive loss before reclassifications	(55)	(117)	(337)	(509)
Less: Amount reclassified from accumulated other comprehensive income	—	1,580	(553)	1,027
Net current period other comprehensive income (loss)	(55)	(1,697)	216	(1,536)
Balance as of April 2, 2017	$(86)	$ 533	$ (45)	$402

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables provide details about significant amounts reclassified out of each component of AOCI for the three months ended April 1, 2018 and April 2, 2017:

	Three Months Ended April 1, 2018	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from AOCI (In thousands)	Affected Line Item in the Statements of Operations
Gains (losses) on cash flow hedge:		
Foreign currency forward contracts	$ (2,568)	Net revenue
Foreign currency forward contracts	6	Cost of revenue
Foreign currency forward contracts	99	Research and development
Foreign currency forward contracts	230	Sales and marketing
Foreign currency forward contracts	41	General and administrative
	(2,192)	Total before tax
	460	Tax impact
	$ (1,732)	Total, net of tax

	Three Months Ended April 2, 2017	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from AOCI (In thousands)	Affected Line Item in the Statements of Operations
Gains (losses) on cash flow hedge:		
Foreign currency forward contracts	$ 2,035	Net revenue
Foreign currency forward contracts	(13)	Cost of revenue
Foreign currency forward contracts	(19)	Research and development
Foreign currency forward contracts	(364)	Sales and marketing
Foreign currency forward contracts	(59)	General and administrative
	1,580	Total before tax
	(553)	Tax impact
	$ 1,027	Total, net of tax

Note 11. Employee Benefit Plans

The Company grants options and RSUs under the 2016 Incentive Plan (the "2016 Plan"), under which awards may be granted to all employees. Award vesting periods for this plan are generally four years. As of April 1, 2018, approximately 0.6 million shares were reserved for future grants under the 2016 Plan.

Additionally, the Company sponsors an Employee Stock Purchase Plan (the “ESPP”), pursuant to which eligible employees may contribute up to 10% of compensation, subject to certain income limits, to purchase shares of the Company’s common stock. The terms of the plan include a look-back feature that enables employees to purchase stock semi-annually at a price equal to 85% of the lesser of the fair market value at the beginning of the offering period or the purchase date. The duration of each offering period is generally six-months. As of April 1, 2018, approximately 0.8 million shares were available for issuance under the ESPP.

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

Option Activity

Stock option activity during the three months ended April 1, 2018 was as follows:

	Number of shares	Weighted Average Exercise Price Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2017	1,879	$ 34.08
Granted	348	70.15
Exercised	(73)	25.56
Cancelled	—	—
Expired	(5)	20.07
Outstanding as of April 1, 2018	2,149	$ 40.25

RSU Activity

RSU activity during the three months ended April 1, 2018 was as follows:

	Number of shares	Weighted Average Grant Date Fair Value Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2017	1,130	$ 43.22
Granted	608	70.15
Vested	(109)	41.09
Cancelled	(12)	49.67
Outstanding as of April 1, 2018	1,617	$ 53.44

Valuation and Expense Information

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

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The table below sets forth the weighted average assumptions used to estimate the fair value of option grants and purchase rights granted under the ESPP during the three months ended April 1, 2018 and April 2, 2017.

	Three Months Ended			
	Stock Options		ESPP	
	April 1, 2018	April 2, 2017	April 1, 2018	April 2, 2017
Expected life (in years)	4.4	NA	0.5	0.5
Risk-free interest rate	2.32%	NA	1.81%	0.66 %
Expected volatility	30.9%	NA	37.1%	27.6 %
Dividend yield	—	NA	—	—

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
	(In thousands)	
Cost of revenue	$852	$436
Research and development	1,575	1,319
Sales and marketing	2,531	1,247
General and administrative	3,192	2,126
Total stock-based compensation	$8,150	$5,128

As of April 1, 2018, $13.3 million of unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 2.8 years. $72.8 million of unrecognized compensation cost related to unvested RSUs is expected to be recognized over a weighted-average period of 2.8 years.

Note 12. Segment Information

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

- Arlo: Focused on combining an intelligent cloud infrastructure and mobile app with a variety of smart connected devices that transform the way people experience the connected lifestyle;

- Connected Home: Focused on consumers and consists of high-performance, dependable and easy-to-use LTE and WiFi internet networking solutions; and

- SMB: Focused on small and medium-sized businesses and consists of business networking, storage and security solutions that bring enterprise-class functionality to small and medium-sized businesses at an affordable price.

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

The results of the reportable segments are derived directly from the Company’s management reporting system. The results are based on the Company’s method of internal reporting and are not necessarily in conformity with accounting principles generally accepted in the United States. Management measures the performance of each segment based on several metrics,

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NETGEAR, INC.
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including contribution income. Segment contribution income includes all product line segment revenues less the related cost of sales, research and development and sales and marketing costs. Contribution income is used, in part, to evaluate the performance of, and allocate resources to, each of the segments. Certain operating expenses are not allocated to segments because they are separately managed at the corporate level. These unallocated indirect costs include corporate costs, such as corporate research and development, corporate marketing expense and general and administrative costs, amortization of intangibles, stock-based compensation expense, separation expense, restructuring and other charges, litigation reserves, net, interest income and other income (expense), net. The CODM does not evaluate operating segments using discrete asset information.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
	(In thousands, except percentage data)	
Net revenue:		
Arlo	$96,209	$60,712
Connected Home	177,781	194,361
SMB	70,983	68,584
Total net revenue	$344,973	$323,657
Contribution income:		
Arlo	$4,360	$321
Arlo contribution margin	4.5 %	0.5 %
Connected Home	$25,529	$31,712
Connected Home contribution margin	14.4 %	16.3 %
SMB	$18,587	$18,504
SMB contribution margin	26.2 %	27.0 %
Total segment contribution income	$48,476	$50,537
Corporate and unallocated costs	(22,603)	(18,201)
Amortization of intangibles [1]	(2,461)	(4,382)
Stock-based compensation expense	(8,150)	(5,128)
Separation expense	(6,784)	—
Restructuring and other charges	9	(37)
Interest income	748	405
Other income (expense), net	(1,252)	335
Income before income taxes	$7,983	$23,529

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

Operations by Geographic Region

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

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
	(In thousands)	
United States (U.S.)	$228,495	$206,125
Americas (excluding U.S.)	5,125	5,504
EMEA	66,629	58,445
Australia	23,676	33,481
APAC (excluding Australia)	21,048	20,102
Total net revenue	$344,973	$323,657

Long-lived assets by Geographic Region

Long-lived assets include purchased intangibles, goodwill and property and equipment. The Company's property and equipment are located in the following geographic locations:

	As of	
	April 1, 2018	December 31, 2017
	(In thousands)	
United States (U.S.)	$8,835	$ 9,216
Americas (excluding U.S.)	1,711	1,807
EMEA	154	141
China	6,622	6,803
APAC (excluding China)	2,457	2,693
Total property and equipment, net	$19,779	$ 20,660

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 13. Fair Value Measurements

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of April 1, 2018:

	As of April 1, 2018			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Assets:				
Cash equivalents: money-market funds	$14,314	$ 14,314	$ —	$ —
Available-for-sale securities: U.S. treasuries [1]	125,000	125,000	—	—
Available-for-sale securities: certificates of deposit [1]	161	161	—	—
Trading securities: mutual funds [1]	2,281	2,281	—	—
Foreign currency forward contracts [2]	855	—	855	—
Total assets measured at fair value	$142,611	$ 141,756	$ 855	$ —
Liabilities:				
Foreign currency forward contracts [3]	$3,433	$ —	$ 3,433	$ —
Total liabilities measured at fair value	$3,433	$ —	$ 3,433	$ —

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

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

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

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of December 31, 2017:

	As of December 31, 2017			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Assets:				
Cash equivalents: money-market funds	$12,606	$ 12,606	$ —	$ —
Available-for-sale securities: U.S. treasuries [1]	124,670	124,670	—	—
Available-for-sale securities: certificates of deposit [1]	162	162	—	—
Trading securities: mutual funds [1]	2,094	2,094	—	—
Foreign currency forward contracts [2]	1,799	—	1,799	—
Total assets measured at fair value	$141,331	$ 139,532	$ 1,799	$ —
Liabilities:				
Foreign currency forward contracts [3]	$8,192	$ —	$ 8,192	$ —
Total liabilities measured at fair value	$8,192	$ —	$ 8,192	$ —

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

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

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

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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-/A3 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. As of April 1, 2018 and December 31, 2017, 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.

Note 14. 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 the consolidated statements of operations. Accrued restructuring and other charges are classified within other accrued liabilities in the consolidated balance sheets.

No significant restructuring and other charges were recognized during the three months ended April 1, 2018 and April 2, 2017, respectively. Amounts attributable to lease contract termination charges will be paid over the remaining lease term until January 2022. The following table provides a summary of the activity related to accrued restructuring and other charges for the three months ended April 1, 2018:

	Accrued Restructuring and Other Charges at December 31, 2017	Additions	Cash Payments	Adjustments	Accrued Restructuring and Other Charges at April 1, 2018
	(In thousands)				
Restructuring					
Employee termination charges	$6	$ —	$ —	$ (6)	$ —
Lease contract termination and other charges	1,129	—	(133)	(3)	993
Total Restructuring and other charges	$1,135	$ —	$ (133)	$ (9)	$ 993

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended and the Private Securities Litigation Reform Act of 1995. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, the words “believes,” “anticipates,” “plans,” “expects,” “intends,” “could,” “may,” “will,” and similar expression intended to identify forward-looking statements. Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in “Part II—Item 1A—Risk Factors” and “Liquidity and Capital Resources” below. All forward-looking statements in this document are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements. The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes contained in this quarterly report. Unless expressly stated or the context otherwise requires, the terms “we,” “our,” “us” and “NETGEAR” refer to NETGEAR, Inc. and our subsidiaries.

Business and Executive Overview

We are a global company that delivers innovative networking and Internet connected products to consumers and growing businesses. Our products are built on a variety of proven technologies such as wireless (WiFi and LTE), Ethernet and powerline, with a focus on reliability and ease-of-use. Our product line consists of devices that create and extend wired and wireless networks as well as devices that provide a special function and attach to the network, such as IP security cameras and home automation devices and services. These products are available in multiple configurations to address the changing needs of our customers in each geographic region in which our products are sold.

We operate and report in three segments: Arlo, Connected Home, and Small and Medium Business ("SMB"). We believe that this structure reflects our current operational and financial management, and provides the best structure for us to focus on growth opportunities while maintaining financial discipline. Each segment contains leadership focused on product development efforts, both from a product marketing and engineering standpoint, to service the unique needs of their customers. Arlo is focused on combining an intelligent cloud infrastructure and mobile app with a variety of smart connected devices that transform the way people experience the connected lifestyle. The Connected Home segment is focused on consumers and consists of high-performance, dependable and easy-to-use LTE and WiFi internet networking solutions. The SMB segment is focused on small and medium-sized businesses and consists of business networking, storage and security solutions that bring enterprise-class functionality to small and medium-sized businesses at an affordable price. We conduct business across three geographic regions: Americas; Europe, Middle-East and Africa (“EMEA”); and Asia Pacific (“APAC”).

The markets in which all of our segments operate are intensely competitive and subject to rapid technological change. We believe that the principal competitive factors in the consumer and small and medium-sized businesses 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, security, 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. Among these investments is an enhanced focus on cybersecurity relating to our products and systems, as the threat of cyber-attacks and exploitation of potential security vulnerabilities in our industry is on the rise and is increasingly a significant consumer concern.

We sell our products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers ("DMRs"), value-added resellers ("VARs"), and broadband service providers. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Costco, Fry's Electronics, Staples, Target, Wal-Mart, Argos (U.K.), FNAC (Europe), MediaMarkt (Europe), Darty (France), JB HiFi (Australia), Elkjop (Norway) and Sunning and Guomei (China). Online retailers include Amazon.com worldwide, Newegg.com (US), JD.com and Alibaba (China), as well as NBB.com (Germany) and Coolblue.com (Netherlands). 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”), xDSL, 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. We expect that these wholesale distributors and retailers will continue to contribute a significant percentage of our net revenue for the foreseeable future.

On February 6, 2018, we announced that our Board of Directors had unanimously approved the pursuit of a separation of our Arlo business from us (the “Separation”). The Separation is expected to be effected through an initial public offering (“IPO”) of newly issued shares of the common stock of Arlo Technologies, Inc. (“Arlo”), which will hold the Arlo business. We expect Arlo to issue less than 20% of its common stock in the IPO, which is expected to be completed in the second half of fiscal 2018, with us to retain the remaining interest. We currently intend that, following the IPO, we will complete the Separation by distributing the shares of Arlo common stock then held by us to our stockholders in a manner generally intended to qualify as tax-free to our stockholders for U.S. federal income tax purposes. We also announced that we expect Matthew McRae, its Senior Vice President of Strategy, to serve as Arlo’s Chief Executive Officer upon the completion of the IPO. In April 2018, we confidentially submitted a draft registration statement on Form S-1 to the U.S. Securities and Exchange Commission relating to the proposed IPO.

The Separation, including the IPO and the Distribution, will be subject to market, tax and legal considerations, final approval by the Company’s Board of Directors and other customary requirements. This Quarterly Report on Form 10-Q does not constitute an offer to sell or a solicitation of an offer to buy securities, and shall not constitute an offer, solicitation or sale in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of that jurisdiction.

We expect to incur significant costs in connection with our planned separation of our Arlo business. These costs relate primarily to IT costs, third-party advisory and consulting services and legal services. Additionally, we expect to incur dis-synergies resulting from the planned separation primarily relating to incremental personnel and facilities related expenditure to establish Arlo as a stand-alone company. During the three months ended April 1, 2018, we incurred $6.8 million of separation expense. We expect to continue to incur additional separation expense in 2018 until we complete the planned separation of our Arlo business. We currently estimate that such additional separation costs, solely in the three months ended July 1, 2018, will be approximately $10.0 million, although that estimate is subject to a number of assumptions and uncertainties.

During the three months ended April 1, 2018, we experienced a 6.6% increase in net revenue while income from operations fell 62.8% compared to the prior year period. The increase in net revenue was attributable to the performance of our Arlo and SMB segments which saw net revenue increase by 58.5% and 3.5%, respectively, partially offset by decline in the Connected Home segment of 8.5%. The increase in Arlo segment net revenue was mainly driven by our Arlo cameras which continue to experience strong demand across all geographic regions. SMB experienced an increase in net revenue mainly due to switch growth compared to the prior year period. The decrease in Connected Home segment net revenue was primarily due to lower net revenue of broadband modem and gateway, mobile, and powerline products, partially offset by an increase in net revenue of home wireless products. Net revenue from service provider customers fell $11.4 million accounting for the large majority of the decline. Operating expenses increased $21.9 million in the three months ended April 1, 2018 compared to the prior year period as a result of separation expense of $6.8 million, increased research and development of $6.3 million, sales and marketing of $5.4 million and general and administrative of $3.5 million. The increase in operating expenses was offset by higher gross margin achievement resulting in an overall decline in income from operations of $14.3 million compared to the prior year period.

On a geographic basis, net revenue increased in the Americas and EMEA, and declined in APAC in the three months ended April 1, 2018 as compared to the prior year period. The increase in Americas net revenue was primarily driven by higher net revenue from our Arlo cameras, partially offset by declines in net revenue of broadband modem and gateway products. The increase in EMEA was primarily driven by increased net revenue from our Arlo cameras, switches and home wireless products, partially offset by a decline in our powerline and broadband modem and gateway products. APAC net revenue

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decreased due to a decline in net revenue of our mobile and broadband modem and gateway products, partially offset by increases in switches and Arlo cameras.

Looking forward, we expect strong growth in our Arlo segment driven by increasing demand for our Arlo cameras and expect to continue to introduce new product and services offerings, while we move forward with our planned separation of the Arlo business. We also expect growth in our SMB segment driven by sales of our 10Gig, PoE, web-managed and app-managed switches, ProAV switches and rackmount storage products. We are targeting low single digit growth in our Connected Home segment compared with the same period of the prior year. We expect service provider net revenue to be approximately $50 to $55 million per quarter and anticipate an increased share of this revenue will be derived from Arlo in fiscal 2018. In addition, we expect a shift in consumer preference away from single point WiFi routers to whole Home WiFi Systems which may require increased marketing and promotional expenditures to achieve similar levels of market share as we have experienced in the WiFi router category.

Results of Operations

The following table sets forth the unaudited condensed consolidated statements of operations for the three months ended April 1, 2018, with the comparable reporting period in the preceding year.

	Three Months Ended					
	April 1, 2018			April 2, 2017		
	(In thousands, except percentage data)					
Net revenue	$344,973	100.0	%	$323,657	100.0	%
Cost of revenue	240,468	69.7	%	226,725	70.1	%
Gross profit	104,505	30.3	%	96,932	29.9	%
Operating expenses:						
Research and development	28,947	8.4	%	22,683	7.0	%
Sales and marketing	43,658	12.6	%	38,229	11.8	%
General and administrative	16,638	4.8	%	13,194	4.1	%
Separation expense	6,784	2.0	%	—	—	%
Restructuring and other charges	(9)	0.0	%	37	0.0	%
Total operating expenses	96,018	27.8	%	74,143	22.9	%
Income from operations	8,487	2.5	%	22,789	7.0	%
Interest income	748	0.2	%	405	0.2	%
Other income (expense), net	(1,252)	(0.4	)%	335	0.1	%
Income before income taxes	7,983	2.3	%	23,529	7.3	%
Provision for income taxes	2,393	0.7	%	7,535	2.4	%
Net income	$5,590	1.6	%	$15,994	4.9	%

Net Revenue by Geographic Region

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

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

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	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Americas	$233,620	10.4 %	$211,629
Percentage of net revenue	67.7 %		65.4 %
EMEA	$66,629	14.0 %	$58,445
Percentage of net revenue	19.3 %		18.0 %
APAC	$44,724	(16.5)%	$53,583
Percentage of net revenue	13.0 %		16.6 %
Total net revenue	$344,973	6.6 %	$323,657

Americas

The increase in Americas net revenue in the three months ended April 1, 2018, compared to the prior year period, was primarily driven by increased net revenue of our Arlo cameras and mobile products, partially offset by declines in broadband modem and gateway products. Additionally, net revenue was negatively impacted by provisions for sales returns and channel promotion activities deemed to be a reduction of net revenue increasing disproportionately compared to the prior year period. Arlo segment net revenue experienced year over year growth of 66.4% as we continued to experience robust demand for our Arlo product portfolio and benefited from an expanded customer channel compared to the prior year period. Connected Home net revenue fell by 3.4%, compared to the prior year period, primarily due to net revenue declines in broadband modem and gateway products. SMB net revenue fell 5.3% compared to the prior year period, primarily due to lower net revenue achievement of our network storage products.

EMEA

EMEA net revenue increased in the three months ended April 1, 2018, compared to the prior year period, driven by increased net revenue from our Arlo cameras, switches and home wireless products. The increase was partially offset by declines in net revenue of our powerline and broadband modem and gateway products. Arlo and SMB net revenue increased by 50.3% and 10.4%, respectively, compared to the prior year period, while Connected Home net revenue slightly declined by 2.6%. The increase in Arlo net revenue was primarily driven by robust demand for the introduction of Arlo Pro 2 cameras.

APAC

APAC net revenue decreased in the three months ended April 1, 2018, compared to the prior year period. The decrease was primarily attributable to lower net revenue of our mobile and broadband modem and gateway products, partially offset by higher net revenue from switches and Arlo cameras. The decline in broadband modem and gateway products was primarily attributable to service provider customers.

Cost of Revenue and Gross Margin

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

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

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Cost of revenue	$240,468	6.1 %	$226,725
Gross margin	30.3 %		29.9 %

Cost of revenue increased for the three months ended April 1, 2018, compared to the prior year period, primarily due to increased net revenue.

Gross margin increased slightly for the three months ended April 1, 2018 compared to the prior year period, primarily due to changes in net segment revenue mix and higher product margin achievement, partially offset by higher provisions for sales returns and channel marketing promotion activities deemed to be a reduction of net revenue increasing disproportionately compared to the prior year period.

We expect gross margin percentage for fiscal 2018 to be in line or slightly improve from the prior year. Forecasting future gross margin percentages is difficult, and there are a number of risks related to our ability to maintain or improve our current gross margin levels. Our cost of revenue as a percentage of net revenue can vary significantly based upon a number of factors such as the following: uncertainties surrounding revenue levels, including future pricing and/or potential discounts as a result of the economy or in response to the strengthening of the U.S. dollar in our international markets, and related production level variances; competition; changes in technology; changes in product mix; variability of stock-based compensation costs; royalties to third parties; fluctuations in freight, duty and repair costs; manufacturing and purchase price variances; changes in prices on commodity components; warranty costs; and the timing of sales, particularly to service provider customers. We expect that revenue derived from paid subscription service plans will increase as a percentage of our revenue in the future, which may have a positive impact on our gross margin. From time to time, however, we may experience fluctuations in our gross margin as a result of the factors discussed above.

Operating Expenses

Research and Development

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

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Research and development expense	$28,947	27.6 %	$22,683

Research and development expense increased for the three months ended April 1, 2018, compared to the prior year period, due to an increase of $2.8 million in personnel-related expenditures, $2.3 million in IT and facility allocations, and $1.2 million in engineering projects and outside professional services. The increased expenditures on engineering projects and outside professional services are a result of continuous investment in strategic focus areas. Research and development headcount increased from 338 as of April 2, 2017 to 377 as of April 1, 2018. The increase in research and development headcount was attributable to the Arlo and Connected Home segments.

We believe that innovation and technological leadership is critical to our future success, and we are committed to continuing a significant level of research and development to develop new technologies, products and services to combat competitive pressures. We continue to invest in research and development to expand our Arlo product offerings and services, grow our cloud

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platform capabilities, and connected home products portfolio including services, expand our 10Gig, PoE, web-managed and app-managed switches, and develop innovative WiFi and LTE Advanced coverage solutions. For the remainder of fiscal 2018, we expect research and development expenses to grow in absolute dollars as we allocate resources to help accelerate growth in key strategic areas, and as we work towards the planned separation of the Arlo business which will result in dis-synergies, mainly associated with duplicate hiring in our corporate research and development function. Research and development expenses will fluctuate depending on the timing and number of development activities in any given quarter and could vary significantly as a percentage of net revenue, depending on actual revenues achieved in any given quarter.

Sales and Marketing

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

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Sales and marketing expense	$43,658	14.2 %	$38,229

Sales and marketing expense increased for the three months ended April 1, 2018, compared to the prior year period, due to an increase in personnel-related expenditures of $4.4 million, IT and facility allocations of $0.5 million, and freight expenditures of $0.4 million. Headcount increased to 339 employees as of April 1, 2018 from 314 employees as of April 2, 2017.

We expect our sales and marketing expense to grow in absolute dollars for the remainder of fiscal year 2018. We expect to continue to invest in brand marketing to strengthen our competitive position in fast growing product categories. In addition, the planned separation of the Arlo business will result in dis-synergies, mainly associated with duplicate hiring for various sales and marketing roles. Expenses may fluctuate depending on revenue levels achieved as certain expenses, such as commissions, are determined based upon the revenues achieved. Forecasting sales and marketing expenses as a percentage of net revenue is highly dependent on expected revenue levels and could vary significantly depending on actual revenues achieved in any given quarter. Marketing expenses will also fluctuate depending upon the timing, extent and nature of marketing programs.

General and Administrative

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

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
General and administrative expense	$16,638	26.1 %	$13,194

General and administrative expense increased for the three months ended April 1, 2018, compared to the prior year period, mainly due to higher personnel-related expenditures of $2.7 million and higher legal and professional services of $0.6 million. Headcount increased to 192 employees as of April 1, 2018 from 163 employees as of April 2, 2017. We expect our general and administrative expenses to grow in absolute dollars in the remainder of fiscal 2018. In addition, the planned separation of the Arlo business will result in dis-synergies, mainly associated with duplicate hiring. The general and administrative expenses could fluctuate depending on a number of factors, including the level and timing of expenditures associated with litigation defense costs in connection with the litigation described in Note 9, Commitments and Contingencies, in

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the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q. Future general and administrative expense increases or decreases in absolute dollars are difficult to predict due to the lack of visibility of certain costs, including legal costs associated with defending claims against us, as well as legal costs associated with asserting and enforcing our intellectual property portfolio and other factors.

Separation Expense

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Separation expense	$6,784	**	$ —

**Percentage change not meaningful.

Separation expense primarily consists of charges for third-party consulting, legal and professional services, IT costs, and other costs related to the planned Arlo separation.

Interest Income and Other Income (Expense), Net

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

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Interest income	$748	84.7 %	$ 405
Other income (expense), net	(1,252)	**	335
Total	$(504)	**	$ 740

**Percentage change not meaningful.

Interest income slightly increased for the three months ended April 1, 2018, compared to the prior year period, due to increases in both short term investment average balances and yields obtained on such balances being more favorable than the prior year period.

Other income (expense), net for the three months ended April 1, 2018, was primarily related to impairment charges of $1.4 million pertaining to an investment. Our foreign currency hedging program effectively reduced volatility associated with hedged currency exchange rate movements during the three months ended April 1, 2018. For a detailed discussion of our hedging program and related foreign currency contracts, refer to Note 6, Derivative Financial Instruments, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

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Provision for Income Taxes

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(In thousands, except percentage data)		
Provision for income taxes	$2,393	(68.2)%	$7,535
Effective tax rate	30.0 %		32.0 %

The income tax provision for the three months ended April 1, 2018 and April 2, 2017, was $2.4 million, or an effective tax rate of 30.0%, and $7.5 million, or an effective tax rate of 32.0%, respectively. The decrease in the effective tax rate for the three months ended April 1, 2018, compared to the three months ended April 2, 2017, resulted primarily from a decrease in the federal statutory rate of 35% to 21% effective as of January 1, 2018. This was offset by certain nondeductible transaction costs resulting from the planned separation of the Arlo business and the establishment of a valuation allowance for a capital loss where tax benefit is not assured. Additionally, tax expense was lower in the three months ended April 1, 2018 due to lower pre-tax earnings compared to the three months ended April 2, 2017.

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

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Act. The Tax Act reduced the U.S. statutory rate from 35% to 21% effective as of January 1, 2018. In addition, certain new complex tax rules related to the taxation of foreign earnings (Global Intangible Low-Taxed Income, Foreign Derived Intangible Income and Base Erosion and Anti-abuse Tax) became effective as of January 1, 2018. Based on information available to date, we have evaluated these provisions and estimate that there is no material impact on the Company's income tax provision for the quarter ended April 1, 2018.

In the year ended December 31, 2017, we recorded the effects of a reduction in tax rates from 35% to 21% on its deferred tax assets and liabilities and to record a one-time transition tax. After the enactment of the Tax Act, the SEC issued Staff Accounting Bulletin No. 118 ("SAB 118") to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. We have calculated an estimate of the impact of the Tax Act in our tax provision for the period ending December 31, 2017 in accordance with our understanding of the Tax Act and guidance available as of the date of the filing of Form 10-K and as a result recorded $48.3 million as additional income tax expense in the fourth fiscal quarter of 2017, the period in which the legislation was enacted. The provisional amount related to the remeasurement of certain deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future, was $26.6 million. The provisional amount related to the one-time transition tax on the mandatory deemed repatriation of foreign earnings was $21.7 million. We have reviewed these amounts based on additional guidance available and have not changed our estimates.

In accordance with SAB 118, we have determined that the $21.7 million of current tax expense recorded in connection with the transition tax on the mandatory deemed repatriation of foreign earnings was a provisional amount and a reasonable estimate at December 31, 2017. We have reviewed these amounts based on additional guidance available and have not changed our estimates.

Segment Information

A description of our products and services, as well as segment financial data, for each segment and a reconciliation of segment contribution income to income before income taxes can be found in Note 12, Segment Information, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

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Arlo

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(in thousands, except percentage data)		
Net revenue	$ 96,209	58.5 %	$ 60,712
Percentage of total net revenue	27.9 %		18.8 %
Contribution income	$ 4,360	**	$ 321
Contribution margin	4.5 %		0.5 %

**Percentage change not meaningful.

Arlo segment net revenue increased significantly for the three months ended April 1, 2018, compared to the prior year period. The rapid expansion of the smart camera market combined with the introduction of our Arlo Pro 2 camera was mainly responsible for the year over year increase. We continue to experience strong demand across all regions for our Arlo product portfolio and we expect to continue to satisfy this demand through new product and service introductions.

Contribution income increased significantly for the three months ended April 1, 2018, compared to the prior year period. The improved profitability was mainly as a result of higher gross margin achieved as a result of effective product cost reduction. Operating expenses as a proportion of net revenue remain consistent, however increased in absolute dollars mainly as a result of higher research and development and sales and marketing expenses. We continue to invest in research and development to expand our Arlo product offerings and services and continue to invest in brand marketing to strengthen our competitive position.

Connected Home

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(in thousands, except percentage data)		
Net revenue	$ 177,781	(8.5)%	$ 194,361
Percentage of total net revenue	51.5 %		60.0 %
Contribution income	$ 25,529	(19.5)%	$ 31,712
Contribution margin	14.4 %		16.3 %

Connected Home segment net revenue decreased for the three months ended April 1, 2018, compared to the prior year period. The decrease in Connected Home net revenue was primarily due to lower net revenue from broadband modem and gateway, powerline and mobile products. The decline was partially offset by increased net revenue of home wireless products driven by our Orbi home WiFi systems. Additionally, provisions for sales returns and channel promotional activity deemed to be contra revenue under authoritative guidance for revenue recognition disproportionately increased compared to the prior year period. On a geographic basis, net revenue fell across all regions in the three months ended April 1, 2018. Declines in service provider net revenue of $11.4 million adversely impacted geographic performance.

Contribution income decreased for the three months ended April 1, 2018, compared to the prior year period, primarily due to lower net revenue. The decline was not met with proportionate reductions to operating expenditures further impacting segment contribution income.

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SMB

	Three Months Ended		
	April 1, 2018	% Change	April 2, 2017
	(in thousands, except percentage data)		
Net revenue	$ 70,983	3.5 %	$ 68,584
Percentage of total net revenue	20.6 %		21.2 %
Contribution income	$ 18,587	0.4 %	$ 18,504
Contribution margin	26.2 %		27.0 %

SMB segment net revenue increased for the three months ended April 1, 2018, compared to the prior year period, primarily due to increased net revenue from switches, partially offset by a decline in network storage.

Contribution income increased slightly for the three months ended April 1, 2018, compared to the prior year period, primarily as a result of the increased net revenue, partially offset by lower gross margin attainment.

Liquidity and Capital Resources

Our principal sources of liquidity are cash, cash equivalents, short-term investments, and cash generated from operations. Our cash equivalents and short-term investments are comprised primarily of money-market funds, U.S. treasury securities, and certificates of deposits. As of April 1, 2018, we had cash, cash equivalents and short-term investments totaling $386.2 million. Our cash and cash equivalents balance increased from $202.9 million as of December 31, 2017 to $258.8 million as of April 1, 2018. Our short-term investments, which represent the investment of funds available for current operations, slightly increased from $126.9 million as of December 31, 2017 to $127.4 million as of April 1, 2018.

As of April 1, 2018, 34% of our cash and cash equivalents and short-term investments were outside of the U.S.. The cash and cash equivalents and short-term investments balances outside of the U.S. are subject to fluctuation based on the settlement of intercompany balances.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
	(In thousands)	
Net cash provided by operating activities	$56,996	$9,261
Net cash used in investing activities	(3,444)	(5,594)
Net cash provided by (used in) financing activities	2,373	(8,467)
Net cash increase (decrease)	$55,925	$(4,800)

Operating activities

Net cash provided by operating activities increased by $47.7 million for the three months ended April 1, 2018 compared to the prior year period, due primarily to improvement in working capital movements, partially offset by lower net income.

Our days sales outstanding ("DSO") decreased to 84 days as of April 1, 2018 as compared to 95 days as of December 31, 2017. DSO as of December 31, 2017 was higher due to seasonal payment terms provided to our larger customers. The adoption of ASU 2014-09, "Revenue from Contracts with Customers" as of January 1, 2018 negatively impacted our DSO as of April 1, 2018 by 4 days, mainly as a result of changes in the balance sheet presentation of certain reserve balances previously shown net within accounts receivable which are now presented as liabilities. Refer to Note 3, Revenue Recognition, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q for the details on adoption impacts. Our accounts payable decreased from $111.9 million as of December 31, 2017 to $96.4 million as of April 1, 2018, primarily as a result of timing of payments. Inventory increased from $245.9 million as of December 31, 2017 to $266.3 million as of April 1, 2018. Ending inventory turns were 3.6 in the three months ended April 1, 2018 up from 4.8 turns in the three months ended December 31, 2017.

Investing activities

Net cash used in investing activities decreased by $2.2 million for the three months ended April 1, 2018 compared to the prior year period. In the three months ended April 2, 2017, we made a $1.4 million payment related to an investment and a $0.7 million payment in connection with our Placemeter acquisition.

Financing activities

Net cash provided by financing activities was $2.4 million in the three months ended April 1, 2018 compared to net cash use of $8.5 million in the prior year period. The change in the financing activities was primarily attributable to the fact of common stocks repurchase activity. No repurchase activity occurred in the three months ended April 1, 2018 whereas we repurchased $11.6 million of our common stocks in the comparative prior year period.

From time to time, the Company's Board of Directors has authorized programs under which the Company may repurchase shares of its common stock. Under the authorizations, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and the price of the Company's common stock. As of April 1, 2018, 2.0 million shares remained authorized for repurchase under the repurchase program. During the three months ended April 1, 2018, we did not repurchase any shares of common stock under the authorizations. During the three months ended April 2, 2017, we repurchased and retired, reported based on trade date, 0.2 million shares of common stock at a cost of $11.6 million. During the three months ended April 1, 2018 and April 2, 2017, we also repurchased and retired, reported based on trade date, approximately 38,000 shares of common stock for both periods, and at a cost of $2.3 million and $1.9 million, respectively, to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs. For a detailed discussion of our common stock repurchases, refer to Note 10, Stockholders' Equity, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

We enter into foreign currency forward-exchange contracts, which typically mature within eleven months, to hedge a portion of our exposure to foreign currency fluctuations of foreign currency-denominated revenue, costs of revenue, certain operating expenses, receivables, payables, and cash balances. We record on the consolidated balance sheets at each reporting period the fair value of our forward-exchange contracts and record any fair value adjustments in our consolidated statements of operations and 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 accumulated other comprehensive income until the related revenue, costs of revenue, or expenses are recognized.

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

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Contractual Obligations

There have been no material changes during the three months ended April 1, 2018 to the contractual obligations disclosed in Part II, Item 7, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. The terms of certain of our facility 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.

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 non-cancelable within 30 days prior to the expected shipment date. As of April 1, 2018, we had approximately $147.2 million in non-cancelable purchase commitments with suppliers. We establish a loss liability for all products we do not expect to sell for which we have committed purchases from suppliers. Such losses have not been material to date. From time to time our suppliers procure unique complex components on our behalf. If these components do not meet specified technical criteria or are defective, we should not be obligated to purchase the materials. However, disputes may arise as a result and significant resources may be spent resolving such disputes.

As of April 1, 2018, we had an estimated long term liability of $17.5 million related to a one-time transaction tax that resulted from the passage of the Tax Act payable in eight annual installments starting April 2018. The first payment of this installment is treated as a current payable. The installment amount will be 8% of the total balance due each year for the first five years. Then it will increase to 15%, 20% and 25% for the 6th, 7th and 8th year, respectively. This provisional amount is subject to change based on additional guidance from and interpretations by U.S. regulatory and standard-setting bodies and changes in assumptions.

As of April 1, 2018, we had $16.4 million of gross unrecognized tax benefits and related interest and penalties. The timing of any payments that could result from these unrecognized tax benefits will depend upon a number of factors. The unrecognized tax benefits have been excluded from the contractual obligations table because reasonable estimates cannot be made of whether, or when, any cash payments for such items might occur. The possible reduction in liabilities for uncertain tax positions in multiple jurisdictions that may impact the statements of operations in the next 12 months is approximately $0.9 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

Off-Balance Sheet Arrangements

As of April 1, 2018, we did not have any off-balance-sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Critical Accounting Policies and Estimates

For a complete description of what we believe to be the critical accounting policies and estimates used in the preparation of our Unaudited Condensed Consolidated Financial Statements, refer to our Annual Report on Form 10-K for the year ended December 31, 2017. Refer to Note 3. Revenue Recognition, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for the updated accounting policy of revenue recognition upon the adoption of ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606) as of January 1, 2018.

Recent Accounting Pronouncements

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

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

During the three months ended April 1, 2018, there were no material changes to our market risk disclosures as set forth in Part II Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

Other than certain controls implemented in connection with adoption of the amended accounting standard for revenue recognition, there have been no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting. It should be noted that any system of controls, however well designed and operated, can provide only reasonable assurance, and not absolute assurance, that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals in all future circumstances.

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PART II: OTHER INFORMATION
Item 1. Legal Proceedings

The information set forth under Note 9, Commitments and Contingencies, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled "Risk Factors" in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

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

We have marked with an asterisk (*) those risks described below that reflect substantive changes from the risks described under Part I, Item 1A "Risk Factors" included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 16, 2018.

*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;

- introductions of new technologies and changes in consumer preferences that result in either unanticipated or unexpectedly rapid product category shifts;

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

- seasonal shifts in end market demand for our products, particularly in our Connected Home and Arlo business segments;

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

- unanticipated decreases or delays in purchases of our products by our significant traditional and online retail customers;

- component supply constraints from our vendors;

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

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- discovery of security vulnerabilities in our products, services or systems, leading to negative publicity, decreased demand or potential liability;
- shift in overall product mix sales from higher to lower margin products, or from one business segment to another, that would adversely impact our margins;
- foreign currency exchange rate fluctuations in the jurisdictions where we transact sales and expenditures in local currency;
- the inability to maintain stable operations by our suppliers and other parties with which we have commercial relationships;
- changes in U.S. and international tax and trade policy that adversely affect customs, tax or duty rates (such as the proposed higher tariffs on products imported from China recently announced by the Trump administration and potential consequences of the "Brexit" process in the United Kingdom);
- unfavorable level of inventory and turns;
- changes in or consolidation of our sales channels and wholesale distributor relationships or failure to manage our sales channel inventory and warehousing requirements;
- delay or failure to fulfill orders for our products on a timely basis;
- delay or failure of our service provider customers to purchase at the volumes that they forecast;
- changes in tax rates or adverse changes in tax laws that expose us to additional income tax liabilities;
- operational disruptions, such as transportation delays or failure of our order processing system, particularly if they occur at the end of a fiscal quarter;
- disruptions or delays related to our financial and enterprise resource planning systems;
- our inability to accurately forecast product demand, resulting in increased inventory exposure;
- allowance for bad debts exposure with our existing customers and new customers, particularly as we expand into new international markets;
- geopolitical disruption, including sudden changes in immigration policies, leading to disruption in our workforce or delay or even stoppage of our operations in manufacturing, transportation, technical support and research and development;
- terms of our contracts with customers or suppliers that cause us to incur additional expenses or assume additional liabilities;
- an increase in price protection claims, redemptions of marketing rebates, product warranty and stock rotation returns or allowance for doubtful accounts;
- litigation involving alleged patent infringement;

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

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- any changes in accounting rules, including the potential impact of our adoption of new revenue recognition standards;
- 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 shift or decline in profit by geographical region that would adversely impact our tax rate; and
- our failure to implement and maintain the appropriate internal controls over financial reporting which may result in restatements of our financial statements.

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

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

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

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

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

*Our plan to separate into two independent, publicly traded companies is subject to various risks and uncertainties and may not be completed in accordance with the expected plans or anticipated timeline, or at all, and will involve significant time, expense and management attention, any of which could negatively impact our businesses, financial condition, results of operations and prospects.

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On February 6, 2018, we announced that our Board of Directors had unanimously approved the pursuit of a separation of our Arlo business from NETGEAR (the "Separation"). The Separation is expected to be effected through an initial public offering ("IPO") of newly issued shares of the common stock of Arlo Technologies, Inc. ("Arlo"), which will hold our Arlo business. We expect Arlo to issue less than 20% of its common stock in the IPO, which is expected to be completed in the second half of fiscal 2018, with NETGEAR to retain the remaining interest. In April 2018, we confidentially submitted a draft registration statement on Form S-1 to the SEC relating to the proposed IPO.

We currently intend that, following the completion of the IPO, we will complete the Separation by distributing the shares of Arlo common stock we then hold to our stockholders in a manner generally intended to qualify as tax-free to our stockholders for U.S. federal income tax purposes (the "Distribution").

The Separation, including the IPO and the Distribution, will be subject to market, tax and legal considerations, final approval by our Board of Directors and other customary requirements.

As the majority stockholder of Arlo following the IPO, we could be adversely affected if the assets and resources of Arlo are insufficient on a standalone basis, or if Arlo encounters difficulties in acquiring or integrating additional assets or resources to conduct its business. In addition, other unanticipated developments, including difficulty in separating the assets and resources of our Arlo business from the rest of our assets and resources, changes to the competitive environment for Arlo's or our respective businesses, possible delays in obtaining or failure to obtain tax opinions, regulatory or other approvals or clearances to approve or facilitate the Separation, including the IPO and the Distribution, uncertainty in financial markets and other challenges in executing the Separation, including the IPO and the Distribution, as planned, could delay or prevent the IPO or the Distribution, or cause the Separation, including the IPO and the Distribution to occur on terms or conditions that are different or less favorable than expected.

We expect that the process of completing the Separation, including the IPO and the Distribution, will be time-consuming and involve significant costs and expenses, which may be significantly higher than those currently anticipated and may not yield a discernible benefit if the Separation, including the IPO and the Distribution, is not completed. Furthermore, the time and energy required from our senior management and other employees to plan and execute the Separation may lead to increased costs, increased expenses, negative effects on relationships with business partners, suppliers, and customers, disruptions in operations and ultimately harm our businesses, financial condition, results of operations and prospects. We may also experience difficulty attracting, retaining and motivating employees during the pendency of the Separation, including the IPO and the Distribution, which could also harm our businesses, financial condition, results of operations and prospects.

If the Separation, including the IPO and the Distribution, is completed, there is a further risk that the sum of the value of the two independent, publicly traded companies will be less than the value of NETGEAR before the Separation. There is also a risk that we may not be able to achieve the full strategic, operational and financial benefits to us and our Arlo business that are anticipated to result from the Separation, including the IPO and the Distribution, or that such benefits may be delayed or not occur at all.

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

We compete in a rapidly evolving and fiercely competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors in the home market for networking and smart home devices include Amazon.com (including Blink and Ring), Apple, Arris, ASUS, Belkin/Linksys (which recently agreed to be purchased by Foxconn), Canary, Devolo, D-Link, Eero, Google (including Nest), Logitech, Night Owl, Samsung, Swann, Synology, Symantec, TP-Link and Western Digital. Our principal competitors in the business market include Allied Telesys, Barracuda, Buffalo, Cisco Systems, Dell, D-Link, Fortinet, Hewlett-Packard Enterprise, Huawei, QNAP Systems, Seagate Technology, SonicWall, Synology, TP-Link, Ubiquiti, WatchGuard and Western Digital. Our principal competitors in the broadband service provider market include Actiontec, Airties, Arcadyan, ARRIS, ASUS, AVM, Compal Broadband, D-Link, Eero, Franklin,

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Google, Hitron, Huawei, Novatel Wireless, Plume, Sagem, Sercomm, SMC Networks, TechniColor, TP-Link, Ubee, ZTE and ZyXEL. Other competitors include numerous local vendors such as Xiaomi in China, and Buffalo in Japan. In addition, these local vendors may target markets outside of their local regions and may increasingly compete with us in other regions worldwide. Our potential competitors also include other consumer electronics vendors, including LG Electronics, Microsoft, Panasonic, Sony, Toshiba and Vizio, who could integrate networking and streaming capabilities into their line of products, such as televisions, set top boxes and gaming consoles, and our channel customers who may decide to offer self-branded networking products. We also face competition from service providers who may bundle a free networking device with their broadband service offering, which would reduce our sales if we 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.

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

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

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

In addition, we have acquired companies and technologies in the past and as a result, have introduced new product lines in new markets. We may not be able to successfully manage integration of the new product lines with our existing products.

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Selling new product lines in new markets will require our management to learn different strategies in order to be successful. We may be unsuccessful in launching a newly acquired product line in new markets which requires management of new suppliers, potential new customers and new business models. Our management may not have the experience of selling in these new markets and we may not be able to grow our business as planned. For example, in 2013, we acquired the AirCard product line from Sierra Wireless. Similarly, we acquired certain technology and intellectual property in connection with our acquisition of AVAAK, Inc. in 2012 that was key to the development of our Arlo Smart security camera products. If we are unable to effectively and successfully further develop these new product lines, we may not be able to increase or maintain our sales and our gross margins may be adversely affected.

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

- loss of or delay in revenue and loss of market share;

- negative publicity and damage to our reputation and brand;

- a decline in the average selling price of our products;

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

- increased levels of product returns.

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

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

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

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

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

Any shortage or delay in the supply of key product components 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. Other factors which may affect our suppliers' ability or willingness to supply components to us include internal management or reorganizational issues, such as roll-out of new equipment which may delay or disrupt supply of previously forecasted components, or industry consolidation and divestitures, which may result in changed business and product priorities among certain suppliers. It could be difficult, costly and time consuming to obtain alternative sources for these components, or to change product designs to make use of alternative components. In addition, difficulties in transitioning from an existing supplier to a new supplier could create delays in component availability that would have a significant impact on our ability to fulfill orders for our products.

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

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

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

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

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

- our reseller agreements generally do not require substantial minimum purchases;

- our customers can stop purchasing and our resellers can stop marketing our products at any time; and

- our reseller agreements generally are not exclusive.

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

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

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

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

All of our products must satisfy safety and regulatory standards and some of our products must also receive government certifications. Our third party manufacturers are primarily responsible for obtaining most regulatory approvals for our products. If our third party manufacturers 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 the Asia Pacific region and any disruptions from natural disasters, health epidemics and political, social and economic instability would affect the ability of our third party manufacturers to manufacture our products. In addition, our third party manufacturers in China have continued to increase our costs of production, particularly in the past couple of years. If these costs continue to increase, it may affect our margins and ability to lower prices for our products to stay competitive. Labor unrest in China may also affect our third party manufacturers as workers may strike and cause production delays. If our third party manufacturers fail to maintain good relations with their employees or contractors, and production and manufacturing of our products is affected, then we may be subject to shortages of products and quality of products delivered may be affected. Further, if our manufacturers or warehousing facilities are disrupted or destroyed, we would have no other readily available alternatives for manufacturing our products and our business would be significantly harmed.

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

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Product security vulnerabilities, data protection breaches and cyber-attacks could disrupt our products or services, and any such disruption could increase our expenses, damage our reputation, harm our business and adversely affect our stock price.

Our products and services may contain unknown security vulnerabilities. For example, the firmware, software and open source software that we or our manufacturing partners have installed on our products may be susceptible to hacking or misuse. In addition, we offer a comprehensive online cloud management service paired with our Arlo Smart security cameras. If malicious actors compromise this cloud service, or if customer confidential information is accessed without authorization, our business will be harmed. Operating an online cloud service is a relatively new business for us and we may not have the expertise to properly manage risks related to data security and systems security. We rely on third-party providers for a number of critical aspects of our cloud services and customer support, including web hosting services, billing and payment processing, and consequently we do not maintain direct control over the security or stability of the associated systems. Our management has spent increasing amounts of time, effort and expense in this area, and in the event of the discovery of a significant product security vulnerability, we would incur additional substantial expenses and our business would be harmed. If we or our third-party providers are unable to successfully prevent breaches of security relating to our products, services or customer private information, including customer videos and customer personal identification information, or if these third-party systems failed for other reasons, it could result in litigation and potential liability for us, damage our brand and reputation, or otherwise harm our business.

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.

System security risks, data protection breaches and cyber-attacks could disrupt our internal operations or information technology systems, 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. Malicious actors may develop and deploy viruses and other advanced persistent threats that are designed to attack our systems, including our internal network, or those of our vendors or customers. Additionally, outside parties may attempt to fraudulently induce our employees to disclose sensitive information in order to gain access to our information technology systems, our data or our customers' data. We have established a crisis management plan and business continuity program. While we regularly test the plan and the program, there can be no assurance that the plan and program can withstand

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an actual or serious disruption in our business, including a data protection breach or cyber-attack. While we have established infrastructure and geographic redundancy for our critical systems, our ability to utilize these redundant systems requires further testing and we cannot be assured that such systems are fully functional. For example, much of our order fulfillment process is automated and the order information is stored on our servers. A significant business interruption could result in losses or damages and harm our business. 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 are able to utilize back-up systems and continue to process and ship our orders. This could cause our stock price to decline significantly.

We devote considerable internal and external resources to network security, data encryption and other security measures to protect our systems and customer data, but these security measures cannot provide absolute security. In addition, many jurisdictions strictly regulate data privacy and protection and may impose significant penalties for failure to comply with these requirements. For example, the European Union's General Data Protection Regulation ("GDPR"), scheduled to take effect in May 2018, has required us to expend significant time and resources to prepare for compliance. Potential breaches of our security measures and the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us, our employees or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, social engineering or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, subject us to significant governmental fines, damage our brand and reputation, or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

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

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

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

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

We sell a significant number of products through broadband service providers worldwide. However, the service provider sales channel is challenging and exceptionally competitive. Difficulties and challenges in selling to service providers include a longer sales cycle, more stringent product testing and validation requirements, a higher level of customization demands, requirements that suppliers take on a larger share of the risk with respect to contractual business terms, competition from established suppliers, pricing pressure resulting in lower gross margins, and irregular and unpredictable ordering habits. For example, rigorous service provider certification processes may delay our sale of new products, or our products ultimately may fail these tests. In either event, we may lose some or all of the amounts we expended in trying to obtain business from the service provider, as well as lose the business opportunity altogether. In addition, even if we have a product which a service provider customer may wish to purchase, we may choose not to supply products to the potential service provider customer if the contract requirements, such as service level requirements, penalties, and liability provisions, are too onerous. Accordingly, our business may be harmed and our revenues may be reduced. We have, in exceptional limited circumstances, while still in contract negotiations, shipped products in advance of and subject to agreement on a definitive contract. We do not record revenue from these shipments until a definitive contract exists. There is risk that we do not ultimately close and sign a definitive contract. If this occurs, the timing of revenue recognition is uncertain and our business would be harmed. In addition, we often commence building custom-made products prior to execution of a contract in order to meet the customer's contemplated launch dates and requirements. Service provider products are generally custom-made for a specific customer and may not be salable to other customers or in other channels. If we have pre-built custom-made products but do not come to agreement on a definitive contract, we may be forced to scrap the custom-made products or re-work them at substantial cost and our business would be harmed.

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

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

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

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developments and constraint on capital expenditures could result in reduced demand from service providers and therefore adversely affect our sales to them. If we do not successfully overcome these challenges, we will not be able to profitably manage our service provider sales channel and our financial results will be harmed.

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

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

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

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

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

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

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

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

Our future success depends in large part upon the continued services of our key technical, 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

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policies. Our business model requires extremely skilled and experienced senior management who are able to withstand the rigorous requirements and expectations of our business. Our success depends on senior management being able to execute at a very high level. The loss of any of our senior management or other key research, development, sales or marketing personnel, particularly if lost to competitors, could harm our ability to implement our business strategy and respond to the rapidly changing needs of our business. While we have adopted an emergency succession plan for the short term, we have not formally adopted a long term succession plan. As a result, if we suffer the loss of services of any key executive, our long term business results may be harmed. While we believe that we have mitigated some of the business execution and business continuity risk with our organization into three business segments with separate leadership teams, the loss of any key personnel would still be disruptive and harm our business, especially given that our business is leanly staffed and relies on the expertise and high performance of our key personnel. In addition, because we do not have a formal long term succession plan, we may not be able to have the proper personnel in place to effectively execute our long term business strategy if Mr. Lo or other key personnel retire, resign or are otherwise terminated.

Changes in tax 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. Foreign jurisdictions have increased the volume of tax audits of multinational corporations. Further, many countries, have either changed or are considering changes to their tax laws. These changes are largely punitive to U.S. multinational corporations. Changes in tax laws could affect the distribution of our earnings, result in double taxation and adversely affect our results. On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law making significant changes to the Internal Revenue Code. In particular, sweeping changes were made to the taxation of foreign operations. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, the transition of U.S. international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017. Additionally, new provisions were added to mitigate the potential erosion of the U.S. tax base and to discourage use of low tax jurisdictions to own intellectual property and other valuable intangible assets. While these provisions were intended to prevent specific perceived taxpayer abuse, they may have adverse, unexpected consequences to many taxpayers. At this time, Treasury has not yet issued Regulations on how these laws should be applied and how the underlying calculations are to be prepared. As there is little to no guidance at this time on the preparation of these complex calculations, significant estimates and judgment are required in assessing the consequences. The company is still quantifying the effects of the tax law change. As we complete our analysis and prepare necessary data, and interpret any additional guidance, we may make adjustments to provisional amounts that we have recorded that may materially impact our provision for income taxes in the period in which the adjustments are made. We urge our stockholders to consult with their legal and tax advisors with respect to the legislation and potential tax consequences of investing in our stock.

In addition to the impact of the Tax Act on our federal taxes, the U.S. law may impact the taxation in other jurisdictions such as state income taxes. The various state legislatures have not had sufficient time to respond to the Tax Act. Accordingly it is uncertain as to how the laws will apply in the various state jurisdictions. Additionally, other foreign governing bodies may enact changes in their tax laws in reaction to the Tax Act that could result in changes to our global tax position and materially affect our financial position.

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

The United Kingdom HMRC (Her Majesty’s Revenue and Customs) began an inquiry regarding the application of UK Diverted Profits Tax (DPT), a law which took effect as of April 1, 2015. In assessing the whether they believe the Company is subject to the DPT legislation, UK HMRC has expanded its review to include overall transfer pricing for 2014 through 2016. If we are unsuccessful in defending our positions, our profitability will be reduced.

We received notice from the French Tax Administration on December 21, 2017 of their intent to audit our 2015 and 2016 tax filings for corporate income tax and value-added taxes. While we believe that we have reported and paid the appropriate amount of tax, if we are unsuccessful in defending our positions, our profitability could be reduced.

We are also subject to examination by the Internal Revenue Service, or IRS, and other tax authorities, including state revenue agencies and other foreign governments. While we regularly assess the likelihood of favorable or unfavorable outcomes resulting from examinations by the IRS and other tax authorities to determine the adequacy of our provision for income taxes, there can be no assurance that the actual outcome resulting from these examinations will not materially adversely affect our financial condition and operating results. Additionally, the IRS and several foreign tax authorities have increasingly focused attention on intercompany transfer pricing with respect to sales of products and services and the use of intangibles. Tax authorities could disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. If we do not prevail in any such disagreements, our profitability may be affected.

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

Our business has been and may continue to be affected by a number of factors that are beyond our control, such as general geopolitical, economic and business conditions, conditions in the financial markets, and changes in the overall demand for networking and smart home products. A severe and/or prolonged economic downturn could adversely affect our customers' financial condition and the levels of business activity of our customers. Weakness in, and uncertainty about, global economic conditions may cause businesses to postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for networking products.

In the recent past, slow economic growth throughout various regions worldwide, especially in Europe, presented significant challenges to our business. In addition, current economic challenges in China, including any global economic ramifications of these challenges, may continue to put negative pressure on global economic conditions. If conditions in the global economy, including Europe, China, Australia and the United States, or other key vertical or geographic markets remain uncertain or deteriorate, such conditions could have a material adverse impact on our business, operating results and financial condition. If we are unable to successfully anticipate changing economic and political conditions, we may be unable to effectively plan for and respond to those changes, which could materially adversely affect our business and results of operations.

In addition, the economic problems affecting the financial markets and the uncertainty in global economic conditions resulted in a number of adverse effects including a low level of liquidity in many financial markets, extreme volatility in credit, equity, currency and fixed income markets, instability in the stock market and high unemployment. For example, the challenges faced by the European Union to stabilize some of its member economies, such as Greece, Portugal, Spain, Hungary and even Italy, have had international implications affecting the stability of global financial markets and hindering economies worldwide. Many member nations in the European Union have been addressing the issues with controversial austerity measures. In addition, the potential consequences of the "Brexit" process in the United Kingdom have led to significant uncertainty in the region. Should the European Union monetary policy measures be insufficient to restore confidence and stability to the financial markets, or should the United Kingdom's "Brexit" decision lead to additional economic or political instability, the recovery of the global economy, including the U.S. and European Union economies where we have a significant presence, could be

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hindered or reversed, which could have a material adverse effect on us. There could also be a number of other 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.

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

International sales comprise a significant amount of our overall net revenue. International sales were approximately 34% of overall net revenue in each of the first quarter of 2018 and fiscal 2017, respectively. We continue to be committed to growing our international sales, and while we have committed resources to expanding our international operations and sales channels, these efforts may not be successful. International operations are subject to a number of other risks, including:

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

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

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

Our operations are routinely subject to audit by tax authorities in various countries. Many countries have indirect tax systems where the sale and purchase of goods and services are subject to tax based on the transaction value. These taxes are commonly referred to as value-added tax (VAT) or goods and services tax (GST). In addition, the distribution of our products subjects us to numerous complex customs regulations, which frequently change over time. Failure to comply with these systems and regulations can result in the assessment of additional taxes, duties, interest and penalties. While we believe we are in compliance with local laws, there is no assurance that tax and customs authorities agree with our reporting positions and upon audit may assess us additional taxes, duties, interest and penalties. If this occurs and we cannot successfully defend our position, our profitability will be reduced.

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

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

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

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

We plan to continue to evolve our historically hardware-centric business model towards a model that includes more sophisticated software offerings. 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. Any increased investment in software research and development may materially adversely affect our financial condition and operating results.

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We may spend a proportionately greater amount on software research and development in the future. If we cannot proportionately decrease our cost structure in response to competitive price pressures, our gross margin and, therefore, our profitability could be adversely affected. In addition, if our software solutions, 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.

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 significant as well. At any time, any of these non-practicing entities, or any other third-party could initiate litigation against us, or we may be forced to initiate litigation against them, which could divert management attention, be costly to defend or prosecute, prevent us from using or selling the challenged technology, require us to design around the challenged technology and cause the price of our stock to decline. In addition, third parties, some of whom are potential competitors, have initiated and may continue to initiate litigation against our manufacturers, suppliers, members of our sales channels or our service provider customers or even end user customers, alleging infringement of their proprietary rights with respect to existing or future products. In the event successful claims of infringement are brought by third parties, and we are unable to obtain licenses or independently develop alternative technology on a timely basis, we may be subject to indemnification obligations, be unable to offer competitive products, or be subject to increased expenses. 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 in Note 9, Commitments and Contingencies, in the Notes to Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

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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, on November 30, 2016 we acquired Placemeter, Inc., a leader in computer vision analytics, to enhance our Arlo product and service offerings. Additionally in April 2013, we closed the acquisition of the AirCard business of Sierra Wireless, Inc., which was our largest acquisition, both in terms of consideration and headcount. Acquisitions involve numerous risks and challenges, including but not limited to the following:

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

As part of undertaking an acquisition, we may also significantly revise our capital structure or operational budget, such as issuing common stock that would dilute the ownership percentage of our stockholders, assuming liabilities or debt, utilizing a substantial portion of our cash resources to pay for the acquisition or significantly increasing operating expenses. Our acquisitions have resulted and may in the future result in charges being taken in an individual quarter as well as future periods, which results in variability in our quarterly earnings. In addition, our effective tax rate in any particular quarter may also be impacted by acquisitions. Following the closing of an acquisition, we may also have disputes with the seller regarding contractual requirements and covenants. Any such disputes may be time consuming and distract management from other aspects of our business. In addition, if we increase the pace or size of acquisitions, we will have to expend significant management time and effort into the transactions and the integrations and we may not have the proper human resources bandwidth to ensure successful integrations and accordingly, our business could be harmed.

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

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

We manufacture and sell products which contain electronic components, and such components may contain materials that are subject to government regulation in both the locations that we manufacture and assemble our products, as well as the locations where we sell our products. For example, certain regulations limit the use of lead in electronic components. To our knowledge, we maintain compliance with all applicable current government regulations concerning the materials utilized in our products, for all the locations in which we operate. Since we operate on a global basis, this is a complex process which requires continual monitoring of regulations and an ongoing compliance process to ensure that we and our suppliers are in compliance with all existing regulations. There are areas where new regulations have been enacted which could increase our cost of the components that we utilize or require us to expend additional resources to ensure compliance. For example, the SEC's “conflict minerals” rules apply to our business, and we are expending significant resources to ensure compliance. The implementation of these requirements by government regulators and our partners and/or customers could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of certain components used in our products. In addition, the supply-chain due diligence investigation required by the conflict minerals rules will require expenditures of resources and management attention regardless of the results of the investigation. If there is an unanticipated new regulation which significantly impacts our use of various components or requires more expensive components, that regulation would have a material adverse impact on our business, financial condition and results of operations.

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

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

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federal or foreign governmental authorities charged with the enforcement of those laws and regulations, may also impact our business in ways we are currently unable to predict. Any failure on our part or on the part of our employees, agents, distributors or other business partners to comply with the laws and regulations governing competition can result in negative publicity and diversion of management time and effort and may subject us to significant litigation liabilities and other penalties.

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

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

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

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

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

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

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

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. A port worker strike, work slow-down or other transportation disruption in Long Beach, California, where we have a significant distribution center, could significantly disrupt our business. For example, a series of work stoppages and slow-downs arising from labor disputes at the Long Beach port and other West Coast ports, particularly in the first quarter of 2015, negatively impacted our ability to timely deliver certain product shipments to the United States and resulted in additional transportation expense. Our international freight is regularly subjected to inspection by governmental entities. If our delivery times increase unexpectedly for these or any other reasons, our ability to deliver products on time would be materially adversely affected and result in delayed or lost revenue as well as customer imposed penalties. In addition, if increases in fuel prices occur, our transportation costs would likely increase. Moreover, the cost of shipping our products by air freight is greater than other methods. From time to time in the past, we have shipped products using extensive air freight to meet unexpected spikes in demand, shifts in demand between product categories, to bring new product introductions to market quickly and to timely ship products previously ordered. If we rely more heavily upon air freight to deliver our products, our overall shipping costs will increase. A prolonged transportation disruption or a significant increase in the cost of freight could severely disrupt our business and harm our operating results.

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

A substantial portion of our sales are on an open credit basis, with typical payment terms of 30 to 60 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor individual customer financial viability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts.

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

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

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

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

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

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

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

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

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

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

If we are unable to 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.

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

Our corporate headquarters are located in Northern California and one of our warehouses is located in Southern California, both of which are regions known for seismic activity. Substantially all of our critical enterprise-wide information technology systems, including our main servers, are currently housed in colocation facilities in Mesa, Arizona. While our critical information technology systems are located at colocation facilities in a different geographic region in the United States, our headquarters and warehouses remain susceptible to seismic activity so long as they are located in California. In addition, 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.

In addition, war, terrorism, geopolitical uncertainties, public health issues, sudden changes in trade and immigration policies (such as the proposed higher tariffs on products imported from China recently announced by the Trump administration), and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on us, our suppliers, logistics providers, manufacturing vendors and customers. Our business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks and other hostile acts, labor disputes, public health issues, and other events beyond our control. For example, labor disputes at manufacturing facilities in China have led to workers going on strike, and labor unrest could materially affect our third-party manufacturers' abilities to manufacture our products.

Such events could decrease demand for our products, make it difficult, more expensive or impossible for us to make and deliver products to our customers or to receive components from our 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.

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.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
(a) None.
(b) None.
(c) Repurchase of Equity Securities by the Company

Period	Total Number of Shares Purchased (2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2018 - January 28, 2018	305	$ 61.65	—	1,957,463
January 29, 2018 - February 25, 2018	7,704	$ 69.69	—	1,957,463
February 26, 2018 - April 1, 2018	30,050	$ 57.11	—	1,957,463
Total	38,059	$ 59.70	—	

(1) From time to time, our Board of Directors has authorized programs under which we may repurchase shares of our common stock, depending on market conditions, in the open market or through privately negotiated transactions. During the three months ended April 1, 2018, we did not repurchase any shares of common stock under the authorizations.

(2) During the three months ended April 1, 2018, we repurchased, as reported based on trade date, approximately 38,000 shares of common stock at a cost of $2.3 million to facilitate tax withholding for RSUs.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of the registrant	10-Q	8/4/2017	3.1	
3.2	Amended and Restated Bylaws of the registrant	8-K	4/20/2018	3.2	
4.1	Form of registrant's common stock certificate	S-1/A	7/14/2003	4.1	
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer				X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer				X
32.1#	Section 1350 Certification of Principal Executive Officer				X
32.2#	Section 1350 Certification of Principal Financial Officer				X
101.INS	XBRL Instance Document				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

This certification is deemed to accompany this Form 10-Q and will not be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) or otherwise subject to the liabilities of that section. This certification will not be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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SIGNATURES

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

NETGEAR, INC.
Registrant
/s/ CHRISTINE M. GORJANC
Christine M. Gorjanc
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: May 4, 2018