

NETGEAR, INC  
Form 10-K  
February 19, 2016  
Table of Contents

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

Form 10-K

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

For the fiscal year ended December 31, 2015

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)

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

350 East Plumeria Drive,  
San Jose, California

95134  
(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code  
(408) 907-8000

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

Title of each class

Name of each exchange on which registered

Common Stock, par value \$0.001

The NASDAQ Stock Market LLC  
(NASDAQ Global Select Market)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements

Edgar Filing: NETGEAR, INC - Form 10-K

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                         |                       |                           |                                  |
|-------------------------|-----------------------|---------------------------|----------------------------------|
| Large Accelerated filer | <input type="radio"/> | Accelerated filer         | <input checked="" type="radio"/> |
| Non-Accelerated filer   | <input type="radio"/> | Smaller reporting company | <input type="radio"/>            |

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of June 28, 2015 was approximately \$401.9 million. Such aggregate market value was computed by reference to the closing price of the common stock as reported on the Nasdaq Global Select Market on June 26, 2015 (the last business day of the Registrant's most recently completed fiscal second quarter). Shares of common stock held by each executive officer and director and each entity that owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the registrant's Common Stock, \$0.001 par value, was 32,418,414 shares as of February 12, 2016.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Registrant's 2016 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

---

Table of Contents

## TABLE OF CONTENTS

## PART I

|          |                                  |           |
|----------|----------------------------------|-----------|
| Item 1.  | <u>Business</u>                  | <u>1</u>  |
| Item 1A. | <u>Risk Factors</u>              | <u>10</u> |
| Item 1B. | <u>Unresolved Staff Comments</u> | <u>31</u> |
| Item 2.  | <u>Properties</u>                | <u>31</u> |
| Item 3.  | <u>Legal Proceedings</u>         | <u>31</u> |
| Item 4.  | <u>Mine Safety Disclosures</u>   | <u>31</u> |

## PART II

|          |   |            |
|----------|---|------------|
| Item 5.  | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>32</u>  |
| Item 6.  | <u>Selected Financial Data</u>  | <u>35</u>  |
| Item 7.  | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>37</u>  |
| Item 7A. | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | <u>53</u>  |
| Item 8.  | <u>Financial Statements and Supplementary Data</u>  | <u>55</u>  |
| Item 9.  | <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>                         | <u>100</u> |
| Item 9A. | <u>Controls and Procedures</u>  | <u>100</u> |
| Item 9B. | <u>Other Information</u>  | <u>100</u> |

## PART III

|          |   |            |
|----------|---|------------|
| Item 10. | <u>Directors, Executive Officers and Corporate Governance</u>   | <u>100</u> |
| Item 11. | <u>Executive Compensation</u>   | <u>101</u> |
| Item 12. | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | <u>101</u> |
| Item 13. | <u>Certain Relationships and Related Transactions, and Director Independence</u>                      | <u>101</u> |
| Item 14. | <u>Principal Accounting Fees and Services</u>   | <u>101</u> |

## PART IV

|          |  |            |
|----------|--|------------|
| Item 15. | <u>Exhibits, Financial Statement Schedules</u> | <u>102</u> |
|          | <u>Signatures</u>                              | <u>103</u> |
|          | <u>Index to Exhibits</u>                       | <u>105</u> |

---

Table of Contents

PART I

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

Item 1. Business

General

We are a global networking company that delivers innovative products to consumers, businesses and service providers. Our business is managed in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home networking, home video security, storage and digital media products. The commercial business unit consists of business networking, storage and security solutions that bring enterprise class functionality down to small and medium-sized businesses at an affordable price. The service provider business unit consists of made-to-order and retail-proven whole home networking hardware and software solutions as well as 4G LTE hotspots sold to service providers for sale to their subscribers. We are organized into the following three geographic territories: Americas; Europe, Middle-East and Africa (“EMEA”) and Asia Pacific (“APAC”). For further detail, refer to Note 12, Segment Information, Operations by Geographic Area and Customer Concentration, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

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

In the years ended December 31, 2015, 2014, and 2013, we generated net revenue of \$1.30 billion, \$1.39 billion, and \$1.37 billion, respectively.

Markets

Our mission is to be the innovative leader in connecting the world to the Internet. This includes our goal of being the leading provider of innovative networking products to the consumer, business, and service provider markets. A number of factors are driving today's demand for networking products within these markets. As the number of Internet connected devices, such as smart phones, laptops, tablets, and Smart Home and Internet-of-thing devices increase, networks - especially WiFi networks - are being deployed more broadly in order to share information and resources among users and devices. This information and resource sharing occurs internally, through a local area network, or externally, via the Internet. To take advantage of complex applications, advanced communication capabilities and rich multimedia content, users are upgrading their Internet connections by deploying high-speed broadband access technologies. Users also seek the convenience and flexibility of operating their laptops, smart phones, tablets and related computing devices while accessing their content in a more mobile, or wireless, manner. In addition, market demand for Smart Home and Internet connected products has increased significantly, where users seek to connect their televisions, game consoles, HD streaming players, security cameras, thermostats, smoke detectors, etc. to the Internet. As a result, the speed, coverage range, and reliability of the in home WiFi network has become a higher priority among households.

## Table of Contents

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

### Sales Channels

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

**Wholesale Distribution.** Our distribution channel supplies our products to retailers, e-commerce resellers, DMRs, VARs and broadband service providers. We sell directly to our distributors, the largest of which are Ingram Micro, Inc., D&H Distributing Company and Tech Data Corporation.

**Retailers.** Our retail channel primarily supplies products that are sold into the consumer market. We sell directly to, or enter into consignment arrangements with, a number of our traditional and online retailers. The remaining traditional retailers, as well as our online retailers, are fulfilled through wholesale distributors. We work directly with our retail channels on market development activities, such as co-advertising, on-line promotions and video demonstrations, instant rebate programs, event sponsorship and sales associate training. Our largest retailers include Best Buy Co., Inc., Amazon.com, Inc. and their affiliates.

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

**Broadband Service Providers.** We also supply our products directly to broadband service providers in the United States and internationally providing cable, DSL and 4G LTE broadband. Service providers supply our products to their business and home subscribers. Our largest broadband service providers include Virgin Media Limited and AT&T.

The largest portion of our net revenues was derived from Americas sales in the year ended December 31, 2015. Americas sales as a percentage of net revenue increased from 55.3% in the year ended December 31, 2014 to 61.4% in the year ended December 31, 2015. We have continuously committed resources to our international operations and sales channels. Accordingly, we are subject to a number of risks related to international operations such as macroeconomic and microeconomic conditions, geopolitical instability, preference for locally branded products, exchange rate fluctuations, increased difficulty in managing inventory, challenges of staffing and managing foreign operations, the effect of international sales on our tax structure, and changes in local tax laws. See Note 12, Segment Information, Operations by Geographic Area and Customer Concentration, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for further discussion of net revenue by

geographic region.

Best Buy Co., Inc. and Affiliates accounted for 15% of our net revenue for the year ended December 31, 2015. None of our customers accounted for 10% or more of our net revenue for the years ended December 31, 2014 and 2013. See Note 12, Segment Information, Operations by Geographic Area and Customer Concentration, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for further details on customer concentrations.

#### Product Offerings

Our product line consists of 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 network attached storage, IP security cameras and home automation devices and services. These products are available in multiple configurations to address the needs of our customers in each geographic region in which our products are sold.

Commercial business networking. These products are sold primarily in our commercial business unit and include:

2

---

## Table of Contents

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

• Wireless controllers and access points, which are devices used to manage and control multiple WiFi base stations on a campus or a facility providing WiFi connections to smart phones, tablets, laptops and other computing devices;

• Internet security appliances, which provide Internet access through capabilities such as anti-virus and anti-spam; and

• Unified storage, which delivers file and block based data into a single shared storage system, meeting the demands of small enterprises, education, hospitality and health markets through an easy-to-use interface for managing multiple storage protocols.

Broadband access. Broadband access is a high speed transmission via coaxial cable, phone lines, fiber, or cellular mediums using technologies such as DOCSIS 3.x, xDSL, FTTx or 4G LTE, to connect to the Internet over public broadband networks. We develop networking products that enable connections to these broadband networks that are sold primarily via brick and mortar retail, e-commerce, and service provider channels and include:

• Broadband modems, which are devices that convert the broadband signals into Ethernet data that feeds Internet into homes and offices. We provide modems that connect to DOCSIS 3.x, xDSL, FTTx, and 4G LTE;

• WiFi Gateways, which are WiFi routers with an integrated broadband modem, for broadband Internet access;

• WiFi Hotspots, which create mobile WiFi Internet access that utilizes 3G and 4G LTE data networks for use on the go, and at home in place of traditional wired broadband, Internet access.

Smart Home/ Internet-of-Things Connectivity and Products. Products that create and extend wired and WiFi networks in homes and small businesses to connect devices to Internet as well as devices that provide remote, secure monitoring of homes and businesses. These connectivity and Smart Home products are sold primarily via brick and mortar retail, e-commerce, and service provider channels and include:

• WiFi routers, which create a local area network (LAN) for home or office computer, mobile and Smart Home devices to connect and share a broadband Internet connection;

• WiFi range extenders, which extend the range of an existing WiFi network to eliminate WiFi dead spots;

• Powerline adapters and bridges, which extend wired and WiFi Internet connections to any AC outlet using existing electrical wiring;

• Remote video security systems, which provide WiFi video and audio monitoring and recordings, accessible by smart phones, tablets or PCs and MACs;

• WiFi network adapters, which enable computing devices to be connected to the network via WiFi.

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



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

## Table of Contents

business setting. Our ReadyNAS® family of network attached storage products implements redundant array of independent disks data protection, enabling businesses to store and protect critical data easily, efficiently and intelligently.

Our vision for the home network is about intelligently controlling and monitoring all devices connected to the home network at all times, thus creating a Smart Home. Our focus is to continue to introduce new products into growth areas that form the basis of Smart Homes, such as: the fastest WiFi standards with broadest coverage via latest technology (802.11ac) WiFi routers and repeaters; home network storage products with an easy to use user interface and remote cloud access, higher capacity and resilience; high speed DOCSIS 3.0, xDSL and fiber gateways with more integrated functions; 4G LTE gateways and AirCard hotspots; and home security cameras and automation devices such as our Arlo Smart Home security cameras. We continue to announce and introduce new products in these growth markets.

Our vision for the commercial network is about increased effectiveness and efficiency of the hybrid cloud access network. We believe small and medium-sized enterprises will continue to move into cloud-based applications, such as: Salesforce.com, Ring Central, LifeSize video conferencing, SuccessFactors, Workday, and others. In addition, we believe these enterprises will move into utility-like on demand computing power supplied by third party data centers. Also, increasingly more enterprises are enabling the BYOD (bring your own device) environment allowing smart phones, tablets, and netbooks to be the business computing devices of choice. These trends will place a greater demand on commercial networks. To meet this demand we are introducing next generation commercial products in rapid pace, such as: Power over Ethernet (PoE) switches, 10 gigabit Ethernet switches, high capacity local and remote unified storage, small to medium capacity campus wireless LAN, and security appliances.

## Competition

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

within the consumer markets, companies such as Apple, ASUS, Belkin/Linksys, Devolo, D-Link, Google, Logitech, Nest Labs (owned by Google), Samsung, Swann, Synology, TP Link, and Western Digital;

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

within the service provider markets, companies such as Actiontec, Arcadyan, ARRIS, AVM, Compal Broadband, D-Link, Hitron, Huawei, Novatel Wireless, Sagem, Scientific Atlanta (a Cisco Systems company), Sercomm, SMC Networks, TechniColor, TP-Link, Ubee, ZTE and ZyXEL.

Our potential competitors 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 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 also face significant and increased competition from original design manufacturers ("ODMs") and contract manufacturers ("CMs") who are selling and attempting to sell their products directly to service providers around the world.

Many of our existing and potential competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. As a result, they may have more advanced technology, larger distribution channels, stronger brand names, better customer service and access to more customers than we do. For example, Hewlett-Packard has significant brand name recognition and has an advertising presence substantially greater than ours. Similarly, Cisco Systems is well recognized as a leader in providing networking products to businesses and has substantially greater financial resources than we do. Several of our competitors, such as TP-Link, offer a range of products that directly compete with most of our product offerings. Several of our other competitors primarily compete in a more limited manner. For example, Hewlett-Packard sells networking products primarily targeted at larger businesses or enterprises. However, the competitive environment in which we operate changes rapidly. Other companies with significant resources could also become direct competitors, either through acquiring a competitor or through internal efforts.

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

## Table of Contents

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

### Research and Development

As of December 31, 2015, we had 337 employees engaged in research and development. Our success depends on our ability to develop products that meet changing user needs and to anticipate and proactively respond to evolving technology in a timely and cost-effective manner. Accordingly, we have made investments in our research and development department in order to effectively evaluate new third-party technologies, develop new in-house technologies, and develop and test new products. Our research and development employees work closely with our technology and manufacturing partners to bring our products to market in a timely, high quality and cost-efficient manner.

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

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

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

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

Our internal research and development efforts focus on developing and improving the usability, reliability, functionality, cost and performance of our products.

### Manufacturing

Our primary manufacturers are Hon Hai Precision Industry Co., Ltd., (more commonly known as Foxconn Corporation), Delta Networks Incorporated, and Pegatron Corporation, all of which are headquartered in Taiwan. We also use Flex (also known as FLEXTRONICS) with headquarters in Singapore and the United States and Sky Light Industrial Ltd. which is headquartered in Hong Kong. The actual manufacturing of our products occurs primarily in mainland China and Vietnam, with pilot and low-volume manufacturing in Taiwan on a select basis. We distribute our manufacturing among these key suppliers to avoid excessive concentration with a single supplier. However there was an increase in supplier concentration in 2015. Because substantially all of our manufacturing occurs in mainland China and Vietnam, any disruptions from natural disasters, health epidemics and political, social and economic

instability would affect the ability of our manufacturers to manufacture our products. In addition, our manufacturers in China have continued to increase our costs of production, particularly in the recent years. These increased costs have affected our margins and ability to lower prices for our products to stay competitive. If our manufacturers or warehousing facilities are disrupted or destroyed, we would have no other readily available alternatives for manufacturing our products and our business would be significantly impacted. In addition to their responsibility for the manufacturing of our products, our manufacturers purchase all necessary parts and materials to produce complete, finished goods. To maintain quality standards for our suppliers, we have established our own product quality organization based in Hong Kong and mainland China. They are responsible for auditing and inspecting process and product quality on the premises of our ODMs, CMs, OEMs and JDMs.

We obtain several key components from limited or sole sources. For example, many of the semiconductors and metamaterials used in our products are designed for use in our products and are obtained from sole source suppliers on a purchase order basis. In addition, some components that are used in all our products are obtained 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, wireless local area network chipsets which are used in all of our wireless

## Table of Contents

products and mobile network chipsets which are used in our wireless gateways and hotspots from a limited number of suppliers. Our third party manufacturers generally purchase these components on our behalf on a purchase order basis. If these sources fail to satisfy our supply requirements, our ability to meet scheduled product deliveries would be harmed and we may lose sales and experience increased component costs.

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

## Sales and Marketing

As of December 31, 2015, we had 339 employees engaged in sales, marketing, and technical support. We work directly with our customers on market development activities, such as co-advertising, online promotions and video demonstrations, event sponsorship and sales associate training. We also participate in major industry trade shows and marketing events. Our marketing department is comprised of our channel marketing, product marketing and corporate marketing groups.

Our channel marketing team focuses on working with the sales teams to maximize our participation in channel partner marketing activities and merchandise our products both online and in store.

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

Our corporate marketing group is responsible for defining and building our corporate brand and supporting the business units with creative and marketing strategies and tactics. The group focuses on defining our brand promise and marketing messages on a worldwide basis. This group is also responsible for driving the social media and online marketing strategy, public relations and email marketing programs, events, and corporate websites worldwide, as well as creative production for all product categories.

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

## Customer Support

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

customer support organization to enhance our product offerings, including further simplifying the installation process.

#### Intellectual Property

We believe that our continued success will depend primarily on the technical expertise, speed of technology implementation, creative skills and management abilities of our officers and key employees, plus ownership of a limited but important set of copyrights, trademarks, trade secrets and patents. We primarily rely on a combination of copyright, trademark and trade secret and patent laws, nondisclosure agreements with employees, consultants and suppliers and other contractual provisions to establish, maintain and protect our proprietary rights. We hold approximately 145 issued United States patents that expire between years 2016 and 2033 and 75 foreign patents that expire between 2016 and 2033. In addition, we currently have approximately 100 pending United States and foreign patent applications related to technology and products offered by us. We also rely on third-party licensors for patented hardware and software license rights in technology that are incorporated into and are necessary for the operation and functionality of our products. Our success will depend in part on our continued ability to have access to these technologies.

## Table of Contents

We have trade secret rights for our products, consisting mainly of product design, technical product documentation and software. We also own, or have applied for registration of trademarks, in connection with our products in the United States and internationally, including NETGEAR, AirCard, AirCard Enabled, Aircard Watcher, Watcher, Watcher and Wireless Expert, Around Town, NETGEAR Green, the NETGEAR Green logo, Everybody's Connecting, Arlo, Arlo Q, Arlo logo, The Next Wave of WiFi, Orbi, Skyler, Genie, Genie+, the Genie logo, ReadyShare, Neo TV, the Neo TV logo, NETGEAR Stora, the NETGEAR Stora logo, ProSafe, RangeMax, ReadyNAS, ReadyDrop, ReadyData, ReadyCloud, ReadyDLNA, ReadyRecover, Smart Wizard, ProSecure, the ProSecure logo, Push2TV, Streampro, Ultraline, Proline, Centria, My Media, Nighthawk, Nighthawk x4, Nighthawk x6, NETGEAR Trek, Overdrive, Overdrive 3G/4G Mobile Hotspot logo, Zing Mobile Hotspot, Mingle, Vue, VueZone, Ufast, and X-RAID.

We have registered a number of Internet domain names that we use for electronic interaction with our customers including dissemination of product information, marketing programs, product registration, sales activities, and other commercial uses.

### Seasonal Business

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

### Backlog

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

### Environmental Laws

Our products and manufacturing process are subject to numerous governmental regulations, which cover both the use of various materials as well as environmental concerns. Environmental issues such as pollution and climate change have had significant legislative and regulatory efforts on a global basis, and there are expected to be additional changes to the regulations in these areas. These changes could directly increase the cost of energy, which may have an impact on the way we manufacture products or utilize energy to produce our products. In addition, any new regulations or laws in the environmental area might increase the cost of raw materials we use in our products and the cost of compliance. Other regulations in the environmental area may require us to continue to monitor and ensure proper disposal or recycling of our products. To the best of our knowledge, we maintain compliance with all current government regulations concerning our production processes for all locations in which we operate. Since we operate on a global basis, this is also a complex process that requires continual monitoring of regulations and an ongoing compliance process to ensure that we and our suppliers are in compliance with all existing regulations.

### Employees



As of December 31, 2015, we had 963 full-time employees, with 339 in sales, marketing and technical support, 337 in research and development, 132 in operations, and 155 in finance, information systems and administration. We also utilize a number of temporary staff to supplement our workforce. We have never had a work stoppage among our employees and no personnel are represented under collective bargaining agreements.

Table of Contents

## Long-lived assets

Long-lived assets include purchased intangibles, goodwill and property and equipment. Our property and equipment are located in the following geographic locations (in thousands):

|                                      | As of                |                      |                      |
|--------------------------------------|----------------------|----------------------|----------------------|
|                                      | December 31,<br>2015 | December 31,<br>2014 | December 31,<br>2013 |
| United States (U.S.)                 | \$9,832              | \$12,453             | \$10,273             |
| Canada                               | 3,586                | 4,375                | 2,132                |
| Americas (excluding U.S. and Canada) | —                    | —                    | 28                   |
| EMEA                                 | 468                  | 657                  | 914                  |
| China                                | 6,562                | 10,786               | 11,905               |
| APAC (excluding China)               | 1,936                | 1,423                | 1,942                |
|                                      | \$22,384             | \$29,694             | \$27,194             |

## Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are filed with the Securities Exchange Commission (the "SEC"). We are subject to the informational requirements of the Exchange Act and file or furnish reports, proxy statements, and other information with the SEC. You may read and copy our reports, proxy statements and other information filed by us at the SEC's Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. Our filings are also available to the public over the Internet at the SEC's website at <http://www.sec.gov>.

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

## Executive Officers of the Registrant

The following table sets forth the names, ages and positions of our executive officers as of February 5, 2016.

| Name                   | Age | Position  |
|------------------------|-----|---|
| Patrick C.S. Lo        | 59  | Chairman and Chief Executive Officer  |
| Christine M. Gorjanc   | 59  | Chief Financial Officer   |
| Patrick J. Collins III | 44  | Senior Vice President of Smart Home Products  |
| Michael F. Falcon      | 59  | Senior Vice President of Worldwide Operations and Support                               |
| David J. Henry         | 43  | Senior Vice President of Home Networking  |
| Andrew W. Kim          | 45  | Senior Vice President of Corporate Development, General Counsel and Corporate Secretary |
| John P. McHugh         | 55  | Senior Vice President and General Manager of Commercial Business Unit                   |
| Mark G. Merrill        | 61  | Chief Technology Officer  |
| Tamesa T. Rogers       | 42  | Senior Vice President, Human Resources  |
| Michael A. Werdann     | 47  | Senior Vice President of Worldwide Sales  |

Patrick C.S. Lo is our co-founder and has served as our Chairman and Chief Executive Officer since March 2002. He has also served as interim general manager of our retail business unit since the first quarter of 2014 and has served as

interim general manager of our service provider business unit since the first quarter of 2015. Patrick founded NETGEAR with Mark G. Merrill with the singular vision of providing the appliances to enable everyone in the world to connect to the high speed Internet for information, communication, business transactions, education, and entertainment. From 1983 until 1995, Mr. Lo worked at Hewlett-Packard Company, where he served in various management positions in sales, technical support, product management, and marketing in the U.S. and Asia. Mr. Lo was named the Ernst & Young National Technology Entrepreneur of the Year in 2006. Mr. Lo received a B.S. degree in electrical engineering from Brown University.

Table of Contents

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

Patrick J. Collins III has served as our Senior Vice President of Smart Home Products since January 2016. He has been with NETGEAR since June 2008, most recently serving as our Vice President of Home Automation Products from March 2014 to January 2016, Chief Information Officer from November 2012 to March 2014, and Vice President of Information Technology from October 2010 to November 2012. Prior to NETGEAR, Mr. Collins held leadership positions in the consulting services groups of Oracle Corporation and Computer Sciences Corporation. Mr. Collins received a B.S. degree in Computer Information Systems from Alvernia University.

Michael F. Falcon has served as our Senior Vice President of Worldwide Operations and Support since January 2009, Senior Vice President of Operations from March 2006 to January 2009, and Vice President of Operations from November 2002 to March 2006. Prior to joining us, Mr. Falcon was at Quantum Corporation, where he served as Vice President of Operations and Supply Chain Management from September 1999 to November 2002, Meridian Data (acquired by Quantum Corporation), where he served as Vice President of Operations from April 1999 to September 1999, and Silicon Valley Group, where he served as Director of Operations, Strategic Planning and Supply Chain Management from February 1989 to April 1999. Prior to February 1989, Mr. Falcon served in management positions at SCI Systems, an electronics manufacturer, Xerox Imaging Systems, a provider of scanning and text recognition solutions, and Plantronics, Inc., a provider of lightweight communication headsets. Mr. Falcon received a B.A. degree in Economics with honors from the University of California, Santa Cruz and has completed coursework in the M.B.A. program at Santa Clara University.

David J. Henry has served as our Senior Vice President of Home Networking since January 2016. He has worldwide responsibility for both Product Marketing and Engineering of our home networking products, encompassing product strategy, development and delivery. He has been with NETGEAR since July 2004, most recently serving as our Vice President of Product Management of our Retail Business Unit from March 2011 to January 2016 and as our Senior Director of Product Marketing from October 2010 to March 2011. Prior to NETGEAR, Mr. Henry was a senior product manager for the high technology vertical application at Siebel Systems (acquired by Oracle Corporation). His professional experience also includes business process and information technology consulting with Deloitte Consulting. Mr. Henry received a B.S. degree in Electrical Engineering, with an emphasis on Signal Processing, from the University of Washington and an M.B.A. from the Stanford Graduate School of Business.

Andrew W. Kim has served as our Senior Vice President of Corporate Development, General Counsel and Corporate Secretary since July 2013, Vice President, Legal and Corporate Development and Corporate Secretary from October 2008 until July 2013, and as our Associate General Counsel from March 2008 to October 2008. Prior to joining NETGEAR, Mr. Kim served as Special Counsel in the Corporate and Securities Department of Wilson Sonsini Goodrich & Rosati, a private law firm, where he represented public and private technology companies in a wide range of matters, including mergers and acquisitions, debt and equity financing arrangements, securities law compliance and corporate governance from 2000 to 2003 and 2006 to 2008. In between his two terms at Wilson Sonsini Goodrich & Rosati, Mr. Kim served as Partner in the Business and Finance Department of the law firm Schwartz Cooper Chartered in Chicago, Illinois, and was an Adjunct Professor of Entrepreneurship at the Illinois Institute of

Technology. Mr. Kim holds a J.D. from Cornell Law School, and received a B.A. degree in history from Yale University.

John P. McHugh serves as our Senior Vice President and General Manager of the Commercial Business Unit, overseeing the development and delivery of the industry's premiere line of networking and storage solutions for SMB customers. Prior to joining us in July 2013, Mr. McHugh led the commercial networking business units at both Nortel and Hewlett-Packard. During his career, Mr. McHugh has held leadership roles in R&D, Marketing and Manufacturing, as well as having over 12 years of experience in General Management. Mr. McHugh holds a BS degree in Electrical Engineering and in Computer Science from Rose-Hulman Institute of Technology.

Mark G. Merrill is our co-founder and currently serves as our Chief Technology Officer. In this role, Mr. Merrill continues to guide the emerging market efforts and work closely with the RF engineering team to ensure technical leadership of our wireless networking products. Previously, Mr. Merrill served as our Senior Vice President of Advanced Engineering from May 2013 to January 2015 and as our Chief Technology Officer from January 2003 to April 2013. From September 1999 to January 2003, he

Table of Contents

served as Vice President of Engineering and served as Director of Engineering from September 1995 to September 1999. Mr. Merrill received both a B.S. degree and an M.S. degree in Electrical Engineering from Stanford University.

Tamesa T. Rogers has served as our Senior Vice President, Human Resources since July 2013, Vice President, Human Resources from January 2009 to July 2013, Director, Worldwide Human Resources from September 2006 to January 2009 and as our Senior Human Resources Manager from December 2003 to September 2006. From March 2000 to December 2003, Ms. Rogers worked at TriNet Employer Group, a professional employer organization, as a Human Resources Manager, providing HR consulting to technology companies throughout Silicon Valley. Prior to TriNet, Ms. Rogers served in various human resources functions in several Northern California companies. Ms. Rogers received a B.A. in Communication Studies from the University of California, Santa Barbara and an M.S. in Counseling from California State University, Hayward.

Michael A. Werdann has served as our Senior Vice President of Worldwide Sales since October 2015, Worldwide Senior Vice President of Sales for Consumer Products from March 2015 to October 2015 and Vice President of Americas Sales from December 2003 to March 2015. Since joining us in 1998, Mr. Werdann has served as our United States Director of Sales, E-Commerce and DMR from December 2002 to December 2003 and as our Eastern Regional Sales Director from October 1998 to December 2002. Prior to joining us, Mr. Werdann worked for three years at Iomega Corporation, a computer hardware company, as a Sales Director for the value added reseller sector. Mr. Werdann holds a B.S. Degree in Communications from Seton Hall University.

Item 1A. Risk Factors

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

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

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

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

- 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 retail business;

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

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

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

shift in overall product mix sales from higher to lower margin products, or from one business unit to another, that would adversely impact our margins;

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

Table of Contents

• 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;

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

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

• our inability to accurately forecast product demand, particularly from our service provider sales channel, resulting in increased inventory exposure;

• component supply constraints from our vendors;

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

• unfavorable level of inventory and turns;

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

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

• geopolitical disruption leading to 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;

• 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;



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

any changes in accounting rules.

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

Table of Contents

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

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

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

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

• actual or anticipated changes in the growth rate of the general networking sector, our growth rates or our competitors' growth rates;

• conditions in the financial markets in general or changes in general economic conditions, including government efforts to stabilize currencies;

• interest rate or currency exchange rate fluctuations;

• our ability 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.

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 commercial business, retail, and service provider markets and 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 and sale of our new Arlo Smart Home camera products and to introducing additional and improved models in this line. If these products do not continue to 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. Successfully predicting demand trends is difficult, and it is very difficult to predict the effect introducing a new product will have on existing product sales. We will also need to respond effectively to new product announcements by our competitors by quickly introducing competitive products.

In addition, we have acquired companies and technologies in the past and as a result, have introduced new product lines in new markets. We may not be able to successfully manage integration of the new product lines with our existing products. Selling new product lines in new markets will require our management to learn different strategies in order to be successful. We may be unsuccessful in launching a newly acquired product line in new markets which requires management of new suppliers, potential new customers and new business models. Our management may not have the experience of selling in these new markets and we may not be able to grow our business as planned. For example, in April 2013, we completed the acquisition of the AirCard product line from Sierra Wireless. Similarly, we acquired certain technology and intellectual property in connection with our acquisition of AVAAK, Inc. in July 2012 that has been key to the development of our Arlo Smart Home 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 the retail business unit. 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;

12

---

Table of Contents

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, our net revenue and overall gross margin would likely decline.

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 substantial portion of our products through broadband service providers worldwide. Our service provider business unit accounted for a significant portion of our growth in recent years and became a larger proportion of our business, especially after our acquisition of the Sierra Wireless AirCard business. However, the service provider business is challenging and exceptionally competitive. In the first quarter of 2015, we undertook a reorganization of our service provider business unit to reduce the cost structure of the unit and supporting functions in order to match a reduced revenue outlook. In the first quarter of 2016, we took additional steps to re-size the cost structure of this unit and to redeploy certain resources internally to focus on other initiatives. These reorganization efforts also sought to concentrate our resources on long-term and profitable accounts. The reorganization may not be successful in meeting these goals or the other challenges posed by the service provider channel. 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

Table of Contents

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. 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. These particular challenges are a significant reason for the reduced service provider business unit revenue outlook that we announced in the first quarter of 2015 and that we further reduced in the first quarter of 2016. In addition, service providers may choose to prioritize the implementation of other technologies or the roll out of other services than home networking. Weakness in orders from this industry could have a material adverse effect on our business, operating results, and financial condition. We have seen slowdowns in capital expenditures by certain of our service provider customers in the past, and believe there may be potential for similar slowdowns in the future. Any slowdown in the general economy, over supply, consolidation among service providers, regulatory developments and constraint on capital expenditures could result in reduced demand from service providers and therefore adversely affect our sales to them. If we do not successfully overcome these challenges, we will not be able to profitably manage our service provider sales channel and our financial results will be harmed.

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 which 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, including Virgin Media Limited and 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. 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, 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. In addition, if, as a result of increased leverage, customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our products to a particular customer, which could result in a decrease in our revenue. Consolidation among our customer base may also lead to reduced demand for our products, 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. For example, in February 2015, one of our large retail customers, Staples, announced a proposed acquisition of another large retail customer, Office Depot. If such transaction was approved and completed, it may provide the combined company with increased negotiating power, and it is uncertain how it may impact the aggregate quantities of our products purchased in the future. Consolidation among our service provider customers worldwide may also make it more difficult to grow our service provider business, given the fierce competition

## Table of Contents

for the already limited number of service providers worldwide and the long sales cycles to close deals. For example, in June 2013, Liberty Global, a service provider with operations worldwide, completed its acquisition of Virgin Media Limited, one of our significant customers. Because we have not conducted business with Liberty Global in the past, Virgin Media has been directed by Liberty Global to develop relationships and business with other Liberty Global vendors, many of which are our competitors. In addition, in the first half of 2015, Charter Communications announced agreements to acquire Time Warner Cable and Bright House Networks. Recently, FNAC, a major retail chain in France, has announced the acquisition of Darty, a major retail reseller of ours. If consolidation among our customer base becomes more prevalent, our operating results may be harmed.

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.

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

We compete in a rapidly evolving and fiercely competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors in the home market for networking and Smart Home devices include Apple, ASUS, Belkin/Linksys, Devolo, D-Link, Google, Logitech, Nest Labs (owned by Google), Samsung, Swann, Synology, TP Link, and Western Digital. Our principal competitors in the commercial business market include Allied Telesys, Barracuda, Buffalo, Cisco Systems, Dell, D-Link, Fortinet, Hewlett-Packard, Huawei, QNAP Systems, Seagate Technology, Synology, Ubiquity, WatchGuard and Western Digital. Our principal competitors in the broadband service provider market include Actiontec, Arcadyan, ARRIS, AVM, Compal Broadband, D-Link, Hitron, Huawei, Novatel Wireless, Sagem, Scientific Atlanta (a Cisco Systems company), Sercomm, SMC Networks, TechniColor, TP-Link, Ubee, ZTE and ZyXEL. Other competitors include numerous local



vendors such as Xiomi 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

Table of Contents

manufacturers, and exert more influence on sales channels than we can. 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. For example, in March 2013, Belkin completed its acquisition of the Linksys division from Cisco. Belkin and Linksys are two of our significant competitors. The combined company may have synergies which increase opportunities for Belkin to gain market share, especially in North America. 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 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. For example, in the first quarter of 2013, while transitioning from our existing ReadyNAS product line to our new line of ReadyNAS products, we were not able to execute on the launch of the new product. This led to our inability to have sufficient quantities of the existing line of ReadyNAS products as we had ramped down supply anticipating the transition, which adversely affected our profitability for the quarter.

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.



## Table of Contents

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

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

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

We 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 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. 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. For example, in the first quarter of 2013, our third-party manufacturers were not able to manufacture sufficient quantities of our new line of ReadyNAS products in order to meet demand, adversely affecting our profitability for the quarter. 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

## Table of Contents

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. 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.

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

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

## Table of Contents

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 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 reorganization into three business units, 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.

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

Maintaining the security of our computer information systems and communication systems is a critical issue for us and our customers. Hackers may develop and deploy viruses, worms and other malicious software programs that are designed to attack our products and systems, including our internal network, or those of our vendors or customers. Additionally, outside parties may attempt to fraudulently induce our employees or users of our products to disclose sensitive information in order to gain access to our information technology systems, our data or our customers' data. We have established a crisis management plan and business continuity program. While we regularly test the plan and the program, there can be no assurance that the plan and program can withstand an actual or serious disruption in our business, including a data protection breach or cyber-attack. While we have established infrastructure and geographic redundancy for our critical systems, our ability to utilize these redundant systems requires further testing and we cannot be assured that such systems are fully functional. For example, much of our order fulfillment process is automated and the order information is stored on our servers. A significant business interruption could result in losses or damages and harm our business. 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 resources to network security, data encryption and other security measures to protect our systems and data, but these security measures cannot provide absolute security. 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, trickery or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

Our products and services may contain unknown security vulnerabilities. For example, the firmware and 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 monitoring service paired with our Arlo Smart Home cameras. If hackers 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 of the associated systems. 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

Table of Contents

information, our management would need to spend increasing amounts of time and effort in this area, we would incur substantial expenses, and our business would be harmed.

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. Numerous foreign jurisdictions have been influenced by studies performed by the OECD (Organization of Economic Cooperation and Development) and are increasingly active in evaluating changes to their tax laws. In July 2013 the OECD, which represents a coalition of member countries, issued an action plan containing 15 comprehensive actions intended to address tax base erosion and jurisdictional profit shifting (BEPS). The OECD issued its final recommendations on these measures in May, 2015. Many countries have increased the volume of tax audits they conduct. Further they continue to evaluate and modify their tax laws in light of BEPS. Changes in tax laws could affect the distribution of our earnings, result in double taxation and adversely affect our results.

We have been under examination 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 2010 years. On December 28, 2015, we received tax assessments for the 2011 and 2012 tax years and we intend to appeal this assessment with the Italian tax court. If we are unsuccessful in defending our tax positions, our profitability will be reduced. Additionally, we are under examination in Germany for the 2009 through 2013 tax years for corporate income, trade and valued-added taxes.

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.

We must comply with indirect tax laws in multiple foreign jurisdictions. Audits of our compliance with these rules may result in additional liabilities for tax, interest and penalties related to our international operations which would reduce our profitability.

Our international 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). Failure to comply with these systems can result in the assessment of additional tax, interest and penalties. While we believe we are in compliance with local laws, there is no assurance that foreign tax authorities agree with our reporting positions and upon audit may assess us additional tax, interest and penalties. If this occurs and we cannot successfully defend our position, our profitability will be reduced.

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 40% of overall net revenue in fiscal year 2015 and 46% in fiscal year 2014. 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:

20

---

Table of Contents

• 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;

• 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;

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

• changes in local tax laws or changes in the enforcement, application or interpretation of such laws.

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.

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.

Table of Contents

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. For example, we believe that decreased demand in Europe adversely impacted our net revenue in all three of our business units beginning in fiscal 2013. 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 further, 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. Should the European Union monetary policy measures be insufficient to restore confidence and stability to the financial markets, the recovery of the global economy, including the U.S. and European Union economies where we have a significant presence, could be hindered or reversed, which could have a material adverse effect on us. There could also be a number of 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.

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 our Arlo Smart Home 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. 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;

Table of Contents

• 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.

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.

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

## Table of Contents

customer requirements, and we may not succeed at doing so within a given product's life cycle or at all. Any delay in the development, production or marketing of a new software solution could result in us not being among the first to market, which could further harm our competitive position. In addition, our regular testing and quality control efforts may not be effective in controlling or detecting all quality issues and defects. We may be unable to determine the cause, find an appropriate solution or offer a temporary fix to address defects. Finding solutions to quality issues or defects can be expensive and may result in additional warranty, replacement and other costs, adversely affecting our profits. If new or existing customers have difficulty with our software solutions or are dissatisfied with our services, our operating margins could be adversely affected, and we could face possible claims if we fail to meet our customers' expectations. In addition, quality issues can impair our relationships with new or existing customers and adversely affect our brand and reputation, which could adversely affect our operating results.

If 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 sheet. In addition, significant negative industry or economic trends, such as those that have occurred as a result of the recent economic downturn, including reduced estimates of future cash flows or disruptions to our business could indicate that goodwill or 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. For example, in the fourth fiscal quarter of 2014, we completed our annual impairment test of goodwill and determined that the full carrying value of goodwill allocated to the service provider business unit of \$74.2 million was impaired, and as a result a corresponding charge was reflected in the fourth quarter of 2014.

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

From time to time, we will undertake acquisitions to add new product lines and technologies, gain new sales channels or enter into new sales territories. For example, in June 2012 and June 2013 we acquired select assets of two separate engineering operations in India to enhance our wireless product offerings in our commercial business unit.

Additionally in July 2012, we closed the acquisition of privately held AVAAK, Inc., creators of the VueZone® home security camera system, and in April 2013, we closed the acquisition of the AirCard business of Sierra Wireless, Inc. The AirCard acquisition represents 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;

24

---

Table of Contents

• 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 continue to increase the pace or size of acquisitions, as we have done since mid-2012, we will have to expend significant management time and effort into the transactions and the integrations and we may not have the proper human resources bandwidth to ensure successful integrations and accordingly, our business could be harmed.

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

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

We 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 passed final rules in August 2012 regarding investigation and disclosure of the use of certain "conflict minerals" in our products. These 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

Table of Contents

in the environmental area might increase the cost of raw materials we use in our products. Environmental regulations require us to reduce product energy usage, monitor and exclude an expanding list of restricted substances and to participate in required recover and recycling of our products. While future changes in regulations are certain, we are currently unable to predict how any such changes will impact us and if such impacts will be material to our business. If there is a new law or regulation that significantly increases our costs of manufacturing or causes us to significantly alter the way that we manufacture our products, this would have a material adverse effect on our business, financial condition and results of operations.

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

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

We are 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

## Table of Contents

to indemnification obligations, be unable to offer competitive products, or be subject to increased expenses. Finally, consumer class-action lawsuits related to the marketing and performance of our home networking products have been asserted and may in the future be asserted against us. For additional information regarding certain of the lawsuits in which we are involved, see the information set forth under Note 9, Commitments and Contingencies, in notes to the consolidated financial statements in Item 8 of Part II of this Annual Report on Form 10-K. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

We 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.

The marketability of our AirCard products may suffer if wireless telecommunications operators do not deliver acceptable wireless services.

The success of the AirCard product line depends, in part, on the capacity, affordability, reliability and prevalence of wireless data networks provided by wireless telecommunications operators and on which our AirCard products operate. Currently, various wireless telecommunications operators, either individually or jointly with us, sell our products in connection with the sale of their wireless data services to their customers. Growth in demand for wireless data access may be limited if, for example, wireless telecommunications operators cease or materially curtail operations, fail to offer services that customers consider valuable at acceptable prices, fail to maintain sufficient capacity to meet demand for wireless data access, delay the expansion of their wireless networks and services, fail to offer and maintain reliable wireless network services or fail to market their services effectively.

In addition, the future growth of our AirCard product line depends on the successful deployment of next generation wireless data networks provided by third parties, including those networks for which we are currently developing products. If these next generation networks are not deployed or widely accepted, or if deployment is delayed, there will be no market for the AirCard products we are developing to operate on these networks. If any of these events occurs, or if for any other reason the demand for wireless data access fails to grow, sales of our products will decline or remain stagnant and our business could be harmed.



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. For example, in June 2013, a ship carrying containers of our products among its cargo sank, and the shipment was lost. Although covered by insurance, this loss led to delays in delivery and our receipt of payment. Labor disputes among freight carriers and at ports of entry are

Table of Contents

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.

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. For example, our customer RadioShack Corp. filed for Chapter 11 bankruptcy protection in 2015. Although any resulting loss has not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. To the degree that 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.

We have expanded our operations and infrastructure, which 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. As a result of the acquisition of the AirCard business of Sierra Wireless in 2013, we added two new locations with over 80 personnel housed at each site, one in Carlsbad, California, and one in Richmond, British Columbia. This expansion required enhancements to our existing management information systems, and operational and financial controls. In addition, if we continue to grow, our expenditures will likely be significantly higher than our historical costs. We may not be able to install adequate controls in an efficient and timely manner as our business grows, and our current systems may not be adequate to support our future operations. The difficulties associated with installing and implementing new systems, procedures and controls may place a significant burden on our management, operational and financial resources. In addition, if we grow internationally, we will have to expand and enhance our communications infrastructure. 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

Table of Contents

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.

Table of Contents

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.

Political events, war, terrorism, public health issues, natural disasters and other circumstances could materially adversely affect us.

Our corporate headquarters are located in Northern California and one of our warehouses is located in Southern California, both of which are regions known for seismic activity. 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, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on us, our suppliers, logistics providers, manufacturing vendors and customers. Our business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond our control. For example, labor disputes at manufacturing facilities in China occurred in 2010 and have led to workers going on strike. The recent trend of labor unrest could materially affect our third-party manufacturers' abilities to manufacture our products. In addition, all of our major direct and indirect suppliers of hard disk drives have been affected by record flooding in Thailand in the third fiscal quarter of 2011, and they informed us that our supply chain would be constrained for an indefinite amount of time, up to six months in some cases. Some therefore declared a force majeure event and have stated that, in addition to and because of the supply constraints, pricing for hard disk drives would increase significantly until they were able to

stabilize the situation. As a result, we experienced increased prices in the cost of hard disk drives and ceased accepting any orders containing ReadyNAS products with hard disk drives. In addition, all sales and marketing promotions involving ReadyNAS products were terminated temporarily. Further, we declared the existence of a force majeure event under our contracts with certain customers. Accordingly, our business was harmed. Furthermore, earthquakes and resultant nuclear threats and tsunamis in Japan in March 2011 caused some disruption to our supply of raw materials and components for our products and impacted our operating results in Japan.

Such events could decrease demand for our products, make it difficult or impossible for us to make and deliver products to our customers or to receive components from our suppliers, and create delays and inefficiencies in our supply chain. Should major public health issues, including pandemics, arise, we could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of our manufacturing vendors and component suppliers.

Table of Contents

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal administrative, sales, marketing and research and development facilities currently occupy approximately 142,700 square feet in an office complex in San Jose, California, under a lease that expires in September 2025.

Our international headquarters occupy approximately 10,000 square feet in an office complex in Cork, Ireland, under a lease that expires in January 2027. Our international sales personnel are based out of local sales offices or home offices in Austria, Australia, Belgium, Canada, China, Denmark, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Korea, Poland, Russia, Singapore, Spain, Sweden, Switzerland, the Netherlands, the United Arab Emirates, and the United Kingdom. We also have operations personnel using a leased facility in Hong Kong and Suzhou and utilizes the Guangzhou branch office in conjunction with an office in Tangxia. We also maintain research and development facilities in Carlsbad (US), Beijing and Nanjing (China), Richmond B.C. (Canada), and in Taipei (Taiwan). From time to time we consider various alternatives related to our long-term facilities needs. While we believe our existing facilities provide suitable space for our operations and are adequate to meet our immediate needs, it may be necessary to lease additional space to accommodate future growth. We have invested in internal capacity and strategic relationships with outside manufacturing vendors as needed to meet anticipated demand for our products.

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

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.



Table of Contents

## PART II

- Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our common stock is publicly traded on the Nasdaq Global Select Market ("Nasdaq") under the symbol "NTGR". The following table sets forth for the indicated periods the high and low intraday sales prices for our common stock on the Nasdaq. Such information reflects interdealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

|                                     |         |         |
|-------------------------------------|---------|---------|
| Fiscal Year Ended December 31, 2015 | High    | Low     |
| First Quarter                       | \$36.34 | \$29.81 |
| Second Quarter                      | 34.25   | 29.20   |
| Third Quarter                       | 34.96   | 28.12   |
| Fourth Quarter                      | 45.76   | 28.52   |
| Fiscal Year Ended December 31, 2014 | High    | Low     |
| First Quarter                       | \$36.27 | \$30.16 |
| Second Quarter                      | 35.75   | 31.20   |
| Third Quarter                       | 35.40   | 30.80   |
| Fourth Quarter                      | 36.70   | 29.70   |

Table of Contents

Company Performance

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

The following graph shows a comparison from December 31, 2010 through December 31, 2015 of cumulative total return for our common stock, the Nasdaq Composite Index and the Nasdaq Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Nasdaq Computer Index assume reinvestment of dividends. We have never paid dividends on our common stock and have no present plans to do so.

Holder of Common Stock

On February 16, 2016, there were 22 stockholders of record.

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

Dividend Policy

We have never declared or paid cash dividends on our capital stock. We do not anticipate paying cash dividends in the foreseeable future.

Table of Contents

## 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 |
|---------------------------------------|--------------------------------------|------------------------------|--|--|
| September 28, 2015 - October 25, 2015 | 399,825                              | \$31.69                      | 394,272  | 2,229,695  |
| October 26, 2015 - November 22, 2015  | 746                                  | \$41.40                      | —  | 2,229,695  |
| November 23, 2015 - December 31, 2015 | 1,755                                | \$43.32                      | —  | 2,229,695  |
| Total                                 | 402,326                              | \$31.76                      | 394,272  |  |

(1) On October 21, 2008, October 17, 2014 and July 21, 2015, the Company's Board of Directors authorized management to repurchase up to 6.0 million, 3.0 million and 3.0 million shares of the Company's outstanding common stock, respectively, which, at the time of authorization, were incremental to the remaining shares under the share repurchase programs. Under the authorizations, the Company may repurchase shares of its common stock, depending on market conditions, in the open market or through privately negotiated transactions. 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. During the three months ended December 31, 2015, we repurchased and retired, reported based on trade date, approximately 0.4 million shares of common stock at a cost of \$12.5 million under this authorization.

(2) During the three months ended December 31, 2015, we repurchased and retired, as reported on trade date, approximately 8,000 shares of common stock at a cost of \$0.3 million to help facilitate tax withholding for RSUs. Refer to Note 10, Stockholders' Equity, of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K for more information regarding our stock repurchase programs.

## Recent Sales of Unregistered Securities

None.

Table of Contents

## Item 6. Selected Financial Data

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

We derived the selected consolidated statement of operations data for the years ended December 31, 2015, 2014 and 2013 and the selected consolidated balance sheet data as of December 31, 2015 and 2014 from our audited consolidated financial statements appearing elsewhere in this Form 10-K. We derived the selected consolidated statement of operations data for the years ended December 31, 2012 and 2011 and the selected consolidated balance sheet data as of December 31, 2013, 2012 and 2011 from our audited consolidated financial statements, which are not included in this Form 10-K. Historical results are not necessarily indicative of results to be expected for future periods.

## Consolidated Statement of Operations Data:

|                                 | Year Ended December 31,               |             |             |             |             |
|---------------------------------|---------------------------------------|-------------|-------------|-------------|-------------|
|                                 | 2015 (1)                              | 2014 (1)    | 2013 (1)    | 2012        | 2011        |
|                                 | (In thousands, except per share data) |             |             |             |             |
| Net revenue                     | \$1,300,695                           | \$1,393,515 | \$1,369,633 | \$1,271,921 | \$1,181,018 |
| Cost of revenue (3)             | 933,016                               | 995,597     | 976,018     | 888,368     | 811,572     |
| Gross profit                    | 367,679                               | 397,918     | 393,615     | 383,553     | 369,446     |
| Operating expenses:             |                                       |             |             |             |             |
| Research and development (3)    | 86,499                                | 90,902      | 85,168      | 61,066      | 48,699      |
| Sales and marketing (3)         | 146,794                               | 157,017     | 153,804     | 149,766     | 154,562     |
| General and administrative (3)  | 45,313                                | 46,552      | 48,915      | 45,027      | 39,423      |
| Restructuring and other charges | 6,398                                 | 2,209       | 5,335       | 1,190       | 2,094       |
| Litigation reserves, net        | (2,682)                               | ) (1,011)   | ) 5,354     | 390         | (201)       |
| Goodwill impairment charges     | —                                     | 74,196      | —           | —           | —           |
| Intangibles impairment charges  | —                                     | —           | 2,000       | —           | —           |
| Total operating expenses        | 282,322                               | 369,865     | 300,576     | 257,439     | 244,577     |
| Income from operations          | 85,357                                | 28,053      | 93,039      | 126,114     | 124,869     |
| Interest income                 | 295                                   | 253         | 400         | 498         | 477         |
| Other income (expense), net     | (88)                                  | ) 2,455     | (457)       | ) 2,670     | (1,136)     |
| Income before income taxes      | 85,564                                | 30,761      | 92,982      | 129,282     | 124,210     |
| Provision for income taxes      | 36,980                                | 21,973      | 37,765      | 42,743      | 32,842      |
| Net income                      | \$48,584                              | \$8,788     | \$55,217    | \$86,539    | \$91,368    |
| Net income per share:           |                                       |             |             |             |             |
| Basic (2)                       | \$1.47                                | \$0.25      | \$1.44      | \$2.27      | \$2.46      |
| Diluted (2)                     | \$1.44                                | \$0.24      | \$1.42      | \$2.23      | \$2.41      |

(1) Includes the impact of AirCard acquisition that occurred in April 2013. Refer to Note 2 Business Acquisitions in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

(2) Information regarding calculation of per share data is described in Note 6, Net Income Per Share, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

Table of Contents

(3) Stock-based compensation expense was allocated as follows:

|                            | Year Ended December 31, |         |         |         |       |
|----------------------------|-------------------------|---------|---------|---------|-------|
|                            | 2015                    | 2014    | 2013    | 2012    | 2011  |
|                            | (In thousands)          |         |         |         |       |
| Cost of revenue            | \$1,566                 | \$2,037 | \$1,577 | \$1,347 | \$999 |
| Research and development   | 3,451                   | 4,916   | 3,943   | 2,787   | 2,476 |
| Sales and marketing        | 5,022                   | 6,168   | 5,379   | 4,751   | 5,136 |
| General and administrative | 6,786                   | 6,893   | 6,563   | 5,487   | 5,151 |

Consolidated Balance Sheet Data:

|   | As of December 31, |             |             |             |           |
|---|--------------------|-------------|-------------|-------------|-----------|
|   | 2015               | 2014        | 2013        | 2012        | 2011      |
|   | (In thousands)     |             |             |             |           |
| Cash, cash equivalents and short-term investments | \$278,266          | \$257,129   | \$248,154   | \$376,877   | \$353,695 |
| Working capital                                   | \$505,371          | \$518,849   | \$500,028   | \$603,279   | \$525,268 |
| Total assets                                      | \$1,050,569        | \$1,048,687 | \$1,093,930 | \$1,034,569 | \$971,370 |
| Total current liabilities                         | \$315,772          | \$304,116   | \$300,083   | \$260,930   | \$308,961 |
| Total non-current liabilities                     | \$26,087           | \$23,006    | \$20,064    | \$19,028    | \$23,652  |
| Total stockholders' equity                        | \$708,710          | \$721,565   | \$773,783   | \$754,611   | \$638,757 |

Table of Contents

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

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

Business and Executive Overview

We are a global networking company that delivers innovative products to consumers, businesses and service providers. 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 wired and wireless devices that enable networking, broadband access and network connectivity. These products are available in multiple configurations to address the needs of our end-users in each geographic region in which our products are sold.

We operate in three specific business segments: retail, commercial, and service provider. We believe this structure enables us to better focus our efforts on our core customer segments and allows us to be more nimble and opportunistic as a company overall. Each business unit contains leadership focused on the product development efforts, both from a product marketing and engineering standpoint, to service the unique needs of these customer segments. The retail business unit is focused on individual consumers and consists of high performance, dependable and easy-to-use home networking, home video security, storage and digital media products. The commercial business unit is focused on small and medium-sized businesses and consists of business networking, storage and security solutions that bring enterprise class functionality at an affordable price. The service provider business unit is focused on the service provider market and consists of made-to-order and retail-proven whole home networking hardware and software solutions, as well as 4G LTE hotspots sold to service providers for sale to their subscribers. We conduct business across three geographic regions: Americas; Europe, Middle-East and Africa (“EMEA”) and Asia Pacific (“APAC”).

The retail, commercial business, and broadband service provider markets are intensely competitive and subject to rapid technological change. We believe that the principal competitive factors in the retail, commercial, and service provider markets for networking products include product breadth, size and scope of the sales channel, brand name, timeliness of new product introductions, product availability, performance, features, functionality and reliability, ease-of-installation, maintenance and use, and customer service and support. To remain competitive, we believe we must continue to aggressively invest resources in developing new products and enhancing our current products while continuing to expand our channels and maintaining customer satisfaction worldwide.

We sell our networking products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers (“DMRs”), value-added resellers (“VARs”), and broadband service providers. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Costco, Fry’s Electronics, Staples, Target, Wal-Mart, Argos (U.K.), Dixons (U.K.), PC World (U.K.), 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.

We experienced a decline in net revenue of 6.7% during the year ended December 31, 2015, driven primarily by a reduction in service provider net revenue, partially offset by an increase in retail net revenue. As previously announced, during the first quarter of 2015 we began to execute on our plans to resize our service provider business for higher profitability by focusing on higher margin products and accounts while reducing the cost structure of the service provider business unit and supporting functions to better align with the reduced revenue plan. These efforts continued through the third quarter of 2015. We made further restructuring efforts in January 2016 to this business unit. Retail net revenue increased compared to the prior year, due primarily to an increase in gross shipments of our home security camera, broadband gateways and home wireless products. In addition, the increase in retail net revenue is due to increasing average selling prices, mainly driven by our Nighthawk and Arlo product lines. We continue to see strong demand for our retail products, including the Nighthawk series and recently introduced Arlo Smart Home

## Table of Contents

cameras. Commercial net revenue decreased compared to the prior year due primarily to a reduction in gross shipments of network storage, wireless products and switches driven by a difficult small business climate in Europe caused by weakening foreign currencies compared to the U.S. dollar. On a geographic basis, net revenue increased in the Americas, offset by declines experienced in EMEA and APAC. The increase in the Americas driven primarily by an increase in gross shipments of our home security camera, home wireless and broadband gateways products, partially offset by a decrease in gross shipments of our mobile and multimedia products. The decline in EMEA was driven primarily by a reduction in gross shipments of broadband gateways, home wireless products and switches, partially offset by an increase in gross shipments of home security camera products. The decline in APAC was driven primarily by a reduction in gross shipments of mobile, home wireless, network storage products and switches, partially offset by an increase in gross shipments of our home security camera and broadband gateway products. Similar to EMEA, APAC net revenue was constrained by weakening foreign currencies compared to the U.S. dollar.

Looking forward, we expect growth in our retail business unit mainly driven by gaining additional market share for cable gateway, WiFi high end router and extender products, and home security camera products, and by entering new product category in the Smart Home market. We expect growth in our commercial business unit driven by the sales of our 11 ac WLAN products and web-managed PoE and 10Gig switches. We expect our service provider business unit revenue to further decline in 2016 as we continue to remain focused on improving profitability. We also expect to incur restructuring charges of between \$1.5 million and \$2.5 million during the first fiscal quarter of 2016, as part of a plan to realign and redeploy our resources to maximize our efforts in product lines of the service provider business unit and supporting functions to match the reduced revenue outlook and to concentrate resources on long-term and profitable accounts.

## Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). The preparation of these financial statements requires management to make assumptions, judgments and estimates that can have a significant impact on the reported amounts of assets, liabilities, revenues and expenses. We base our estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. Actual results could differ significantly from these estimates. These estimates may change as new events occur, as additional information is obtained and as our operating environment changes. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We also discuss our critical accounting estimates with the Audit Committee of the Board of Directors. Note 1, The Company and Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements of this Annual Report on Form 10-K describes the significant accounting policies used in the preparation of the consolidated financial statements. We have listed below our critical accounting policies that we believe to have the greatest potential impact on our consolidated financial statements. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

## Revenue Recognition

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



reasonably assured, then revenue is deferred until receipt of the payment from the customer.

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

When applying the relative selling price method, we determine the selling price for each deliverable using vendor-specific objective evidence ("VSOE") of fair value of the deliverable, or when VSOE of fair value is unavailable, its best estimate of selling price ("ESP"), as we have determined it is unable to establish third-party evidence of selling price for the deliverables. In determining

## Table of Contents

VSOE, we require that a substantial majority of the selling prices for a deliverable sold on a stand-alone basis fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical stand-alone transactions falling within +/-15% of the median price. We determine ESP for a deliverable by considering multiple factors including, but not limited to, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The objective of ESP is to determine the price at which we would transact a sale if the deliverable were sold on a stand-alone basis. The determination of ESP is made through consultation with and formal approval by our management, taking into consideration the go-to-market strategy.

We have not made any material changes in the accounting methodology we use to estimate deferred revenue related to product where title has not transferred. We do not believe there will be a material change in the future estimates or assumptions used in our estimate of deferred revenue.

### Allowances for Warranty Obligations, Returns due to Stock Rotation, Sales Incentives and Doubtful Accounts

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

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

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

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

### Valuation of Inventory

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

## Table of Contents

manufacturing accordingly, we could be required to write down the value of additional inventory, which would have a negative effect on our gross profit.

### Goodwill

Goodwill represents the purchase price over estimated fair value of net assets of businesses acquired in a business combination. Goodwill acquired in a business combination is not amortized, but instead tested for impairment at least annually on the first day of the fourth quarter. Should certain events or indicators of impairment occur between annual impairment tests, we will perform the impairment test as those events or indicators occur. Examples of such events or circumstances include the following: a significant decline in our expected future cash flows, a sustained, significant decline in our stock price and market capitalization, a significant adverse change in the business climate, and slower growth rates.

Goodwill is tested for impairment at the reporting unit level by first performing a qualitative assessment to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of the reporting unit is less than its carrying value. We identified the reporting units as retail, commercial and service provider reporting units, as this is the lowest level for which discrete financial information is available and segment management regularly reviews the operating results. The qualitative assessment considers the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in our share price. If the reporting unit does not pass the qualitative assessment, we estimate our fair value and compare the fair value with the carrying value of our net assets. If the fair value is greater than the carrying value of our net assets, no impairment results. If the fair value is less than our carrying value, we would determine the fair value of the goodwill by comparing the implied fair value to the carrying value of the goodwill in the same manner as if the business unit were being acquired in a business combination. Specifically, we would allocate the fair value to all of our assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded to earnings in the consolidated statements of operations.

In the fourth fiscal quarter of 2015, we completed the annual impairment test of goodwill. The test was performed as of the first day of the fourth quarter, or September 28, 2015.

We performed a qualitative test for goodwill impairment of the retail and commercial reporting units as of September 28, 2015. Based upon the results of the qualitative testing, the respective fair values of the retail and commercial reporting units were substantially in excess of these reporting units' carrying values. We believe that it is more-likely-than-not that the fair value of these reporting units are greater than their respective carrying values and therefore performing the first step of the two-step impairment test for the retail and commercial reporting units was unnecessary. No goodwill impairment was recognized for the retail and commercial reporting units in the years ended December 31, 2015, 2014 or 2013.

In the fourth quarter of fiscal year 2014, we recorded an impairment charge of \$74.2 million which was the entire goodwill balance related to the service provider reporting unit in the year ended December 31, 2014. No goodwill impairment was recognized for the service provider reporting units in the year ended December 31, 2013.

For retail and commercial reporting units, we do not believe it is likely that there will be a material change in the estimates or assumptions we use to test for impairment losses on goodwill. However, if the actual results are not consistent with our estimates or assumptions, we may be exposed to a future impairment charge that could be material.

Intangibles, Net

Purchased intangibles with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from four to ten years. Finite-lived intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition.

In the fourth quarter of fiscal year 2015, we saw a decline in net revenue in the service provider reporting unit. According to our customers, purchase constraints will tighten further in 2016 and for the foreseeable future. Due to the decline in the long-term revenue and profit outlook, we performed the recoverability test of the long-lived assets within the service provider reporting unit. We estimated the undiscounted future cash flows directly associated with each asset group and compared the amounts to the carrying value of each asset group. Based on the results of the recoverability test, the sum of undiscounted future cash flows was greater than the carrying value of each asset group and therefore no impairment was recorded. We also reviewed the depreciation and amortization policies for the long-lived asset groups and ensured the remaining useful lives are appropriate.

## Table of Contents

Purchased intangibles determined to have indefinite useful lives are not amortized. Indefinite-lived intangibles, namely in-process research and development (“IPR&D”), are reviewed for impairment at least annually during the fourth quarter and whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Measurement of an impairment loss for indefinite-lived assets that management expects to hold and use is based on the fair value of the asset. Indefinite-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

In the third quarter of 2013, we recorded an impairment charge of \$2.0 million related to the abandonment of certain IPR&D projects obtained in AirCard acquisition in 2013. As of the end of the second fiscal quarter of 2014, all of the remaining IPR&D had reached technical feasibility and was reclassified to definite-lived intangibles with an estimated useful life of four years. We recorded no other impairments of long-lived assets in the years ended December 31, 2015, 2014 or 2013.

### Property and Equipment, Net

Property and equipment are stated at historical cost, less accumulated depreciation. We will perform an impairment test if certain events or indicators of impairment occur. Examples of such events or circumstances include the following: a significant decline in our expected future cash flows, a sustained, significant decline in our stock price and market capitalization, a significant adverse change in the business climate, and slower growth rates.

Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment. Charges related to the impairment of property and equipment were insignificant for the years ended December 31, 2015, 2014 and 2013.

### Income Taxes

We account for income taxes under an asset and liability approach. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences resulting from different treatments for tax versus accounting of certain items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. Our assessment considers the recognition of deferred tax assets on a jurisdictional basis. Accordingly, in assessing our future taxable income on a jurisdictional basis, we consider the effect of its transfer pricing policies on that income. We have placed a valuation allowance against California deferred tax assets since the recovery of the assets is uncertain. We believe that all of our other deferred tax assets are recoverable; however, if there were a change in our ability to recover our deferred tax assets, we would be required to take a charge in the period in which we determined that recovery was not more likely than not.

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



Table of Contents

## Results of Operations

The following table sets forth, for the periods presented, the consolidated statements of operations data, which is derived from the accompanying consolidated financial statements:

|                                 | Year Ended December 31,                |        |    |             |        |    |             |       |   |
|---------------------------------|--|--------|----|-------------|--------|----|-------------|-------|---|
|                                 | 2015                                   |        |    | 2014        |        |    | 2013        |       |   |
|                                 | (In thousands, except percentage data) |        |    |             |        |    |             |       |   |
| Net revenue                     | \$1,300,695                            | 100.0  | %  | \$1,393,515 | 100.0  | %  | \$1,369,633 | 100.0 | % |
| Cost of revenue                 | 933,016                                | 71.7   | %  | 995,597     | 71.4   | %  | 976,018     | 71.3  | % |
| Gross profit                    | 367,679                                | 28.3   | %  | 397,918     | 28.6   | %  | 393,615     | 28.7  | % |
| Operating expenses:             |  |        |    |             |        |    |             |       |   |
| Research and development        | 86,499                                 | 6.7    | %  | 90,902      | 6.5    | %  | 85,168      | 6.2   | % |
| Sales and marketing             | 146,794                                | 11.2   | %  | 157,017     | 11.4   | %  | 153,804     | 11.2  | % |
| General and administrative      | 45,313                                 | 3.5    | %  | 46,552      | 3.3    | %  | 48,915      | 3.6   | % |
| Restructuring and other charges | 6,398                                  | 0.5    | %  | 2,209       | 0.2    | %  | 5,335       | 0.4   | % |
| Litigation reserves, net        | (2,682)                                | ) (0.2 | )% | (1,011)     | ) (0.1 | )% | 5,354       | 0.4   | % |
| Goodwill impairment charges     | —                                      | —      | %  | 74,196      | 5.3    | %  | —           | —     | % |
| Intangibles impairment charges  | —                                      | —      | %  | —           | —      | %  | 2,000       | 0.1   | % |
| Total operating expenses        | 282,322                                | 21.7   | %  | 369,865     | 26.6   | %  | 300,576     | 21.9  | % |
| Income from operations          | 85,357                                 | 6.6    | %  | 28,053      | 2.0    | %  | 93,039      | 6.8   | % |
| Interest income                 | 295                                    | 0.0    | %  | 253         | 0.0    | %  | 400         | 0.0   | % |
| Other income (expense), net     | (88)                                   | ) 0.0  | %  | 2,455       | 0.2    | %  | (457)       | ) 0.0 | % |
| Income before income taxes      | 85,564                                 | 6.6    | %  | 30,761      | 2.2    | %  | 92,982      | 6.8   | % |
| Provision for income taxes      | 36,980                                 | 2.9    | %  | 21,973      | 1.6    | %  | 37,765      | 2.8   | % |
| Net income                      | \$48,584                               | 3.7    | %  | \$8,788     | 0.6    | %  | \$55,217    | 4.0   | % |

## Net Revenue by Geographic Region

Our net revenue consists of gross product shipments, less allowances for estimated returns for stock rotation and warranty, price protection, end-user customer rebates and other sales incentives deemed to be a reduction of net revenue 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 attributed to each geographic region based upon the location of the customer.

|                           | Year Ended December 31,                |          |      |             |      |    |             |
|---------------------------|--|----------|------|-------------|------|----|-------------|
|                           | 2015                                   | % Change | 2014 | % Change    | 2013 |    |             |
|                           | (In thousands, except percentage data) |          |      |             |      |    |             |
| Americas                  | \$797,746                              | 3.5      | %    | \$770,890   | (2.3 | )% | \$789,318   |
| Percentage of net revenue | 61.4                                   | %        |      | 55.3        | %    |    | 57.7        |
| EMEA                      | \$321,714                              | (23.7    | )%   | \$421,887   | 2.2  | %  | \$412,688   |
| Percentage of net revenue | 24.7                                   | %        |      | 30.3        | %    |    | 30.1        |
| APAC                      | \$181,235                              | (9.7     | )%   | \$200,738   | 19.8 | %  | \$167,627   |
| Percentage of net revenue | 13.9                                   | %        |      | 14.4        | %    |    | 12.2        |
| Total net revenue         | \$1,300,695                            | (6.7     | )%   | \$1,393,515 | 1.7  | %  | \$1,369,633 |

2015 vs 2014



The increase in Americas net revenue for the year ended December 31, 2015 compared to the prior year was driven primarily by an increase in gross shipments of our home security camera, home wireless and broadband gateways products, partially offset by a decrease in gross shipments of our mobile and multimedia products. The increase was due primarily to continued growth and increasing average selling prices in the retail business unit driven by strong demand for our products, including the Nighthawk

42

---

## Table of Contents

series and recently introduced Arlo Smart Home cameras. The increase in Americas net revenue was partially offset by a reduction in service provider net revenue as we decided to refocus our service provider business on profitability.

The decrease in EMEA net revenue for the year ended December 31, 2015 compared to the prior year was driven primarily by a reduction in gross shipments of broadband gateways, home wireless products and switches, partially offset by an increase in gross shipments of home security camera products. We were also challenged by a difficult small business market climate caused by weakening foreign currencies compared to the U.S. dollar. The decrease was primarily attributable to a reduction in gross shipments driven, in part, by continued decline in European service provider gross shipment as we restructured our service provider business for profitability instead of gross shipment growth.

The decrease in APAC net revenue for the year ended December 31, 2015 compared to the prior year was driven primarily by a reduction in gross shipments of mobile, home wireless, network storage products and switches, partially offset by an increase in gross shipments of our home security camera and broadband gateway products. Similar to EMEA, APAC net revenue was constrained by weakening foreign currencies compared to the U.S. dollar.

### 2014 vs 2013

The decrease in Americas net revenue for the year ended December 31, 2014 compared to the prior year was driven primarily by a reduction in sales of our home wireless, multimedia, home security camera products and switches, partially offset by an increase in sales of our mobile products and broadband gateways. Net revenue for mobile products increased for the year ended December 31, 2014 as a result of the AirCard acquisition which was completed on April 2, 2013. In contrast to 2013, the positive effect of the acquisition is included in our results of the entire year ended December 31, 2014. In our retail and distribution channels, we managed our inventory levels at our U.S. retail partners to be more aligned with historic levels, which contributed to the decline in the Americas net revenue for the year ended December 31, 2014 compared to the prior year.

The increase in EMEA net revenue for the year ended December 31, 2014 compared to the prior year was driven primarily by an increase in sales of our switches and broadband gateways, partially offset by a reduction in sales of our mobile products. The increase in EMEA net revenue was primarily driven by sales to our service provider customers in fiscal 2014. These positive effects to net revenue in fiscal year 2014 were partially offset by challenges resulting from the macro-economic environment, increased competition and pricing pressures in Europe, and weakening of foreign currencies compared to the U.S. dollar.

The increase in APAC net revenue for the year ended December 31, 2014 compared to the prior year was driven primarily by an increase in sales of our mobile, home wireless and broadband gateway products, partially offset by a reduction in sales of our small business wireless products. Net revenue for mobile products specifically increased for the year ended December 31, 2014 as a result of the AirCard acquisition which was completed on April 2, 2013. In contrast to 2013, the positive effect of the acquisition was included in our results for the entire year ended December 31, 2014.

### 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 acquisition accounting adjustments to inventory.

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 sales incentives, and changes in our cost of goods sold due to fluctuations in prices paid for components, net of vendor rebates, warranty and overhead costs, inbound freight, conversion costs, 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:

|                         | Year Ended December 31,                |          |              |          | 2013 |           |
|-------------------------|--|----------|--------------|----------|------|-----------|
|                         | 2015                                   | % Change | 2014         | % Change |      |           |
|                         | (In thousands, except percentage data) |          |              |          |      |           |
| Cost of revenue         | \$933,016                              | (6.3     | )% \$995,597 | 2.0      | %    | \$976,018 |
| Gross margin percentage | 28.3                                   | %        | 28.6         | %        |      | 28.7 %    |

Table of Contents

## 2015 vs 2014

Cost of revenue decreased for the year ended December 31, 2015 compared to the prior year due primarily to the decrease in net revenue and related product costs attributable, in part, to continued decline in net revenue to service provider customers worldwide, partially offset by an increase in freight costs of \$4.0 million.

Our gross margin slightly decreased for the year ended December 31, 2015 compared to the prior year due primarily to weakening foreign currencies compared to the U.S. dollar and, to a lesser extent, an increase in per unit freight costs. Foreign currency movements had an unfavorable impact of 2 percentage points on the year over year comparison. The decrease was largely offset by the positive effects of lower excess and obsolete inventory charges of \$6.9 million and the decrease in segment product mix toward service provider, which generally maintains lower margins. Net revenue from service providers decreased as a percentage of net revenue to 32.4% in the year ended December 31, 2015, compared to 41.6% in the prior year.

We expect gross margin percentage to increase in the near term, as we expect less net revenue from our service provider business unit as a percentage of total net revenue, which generally carries lower gross margins than the retail and commercial business units. 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 revenues as a percentage of revenues 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 and repair costs; manufacturing and purchase price variances; changes in prices on commodity components; warranty and recall costs; and the timing of sales, particularly to service providers which generally carry lower margins.

## 2014 vs 2013

Cost of revenue increased for the year ended December 31, 2014 compared to the prior year due primarily to the increase in net revenue and related product costs driven by higher shipments, combined with an increase in excess and obsolete inventory charges of \$7.5 million.

Our gross margin slightly decreased for the year ended December 31, 2014 compared to the prior year primarily attributable to the slight increase in segment product mix toward service provider, which generally maintains lower margins. Net revenue from service providers increased as a percentage of net revenue to 41.6% in the year ended December 31, 2014, compared to 40.0% in the prior year.

## Operating Expenses

## Research and Development Expense

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

|                                  | Year Ended December 31,                |          |             |          |            |
|----------------------------------|--|----------|-------------|----------|------------|
|                                  | 2015                                   | % Change | 2014        | % Change | 2013       |
|                                  | (In thousands, except percentage data) |          |             |          |            |
| Research and development expense | \$86,499                               | (4.8     | )% \$90,902 | 6.7      | % \$85,168 |

## 2015 vs 2014

Research and development expense decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in personnel-related costs of \$4.7 million, driven by a reduction in headcount attributable to the restructuring activities executed in the first quarter of 2015. Headcount decreased by 16 to 337 employees at December 31, 2015 compared to 353 employees at December 31, 2014.

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 and products to combat competitive pressures. We

Table of Contents

continue to invest in research and development to expand our cloud platform capabilities, grow our home security camera and home automation device portfolio, and develop innovative whole home WiFi coverage solutions. In the near term, we expect research and development expenses as a percentage of net revenue will slightly increase as we are allocating resources in the key areas that we expect will drive future growth and profitability. 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 revenue depending on actual revenues achieved in any given quarter.

## 2014 vs 2013

Research and development expense increased for the year ended December 31, 2014 compared to the prior year due primarily to an increase of \$3.9 million in personnel and facility-related expenses driven by the overall growth in research and development headcount in comparison to prior year, and an increase of \$2.6 million in variable compensation. The average headcount for the year ended December 31, 2014 increased to 353 from 339 in the prior year as the additional headcount from the AirCard and Arada acquisitions were included in three quarters of 2013 as compared to the entire year in 2014.

## Sales and Marketing Expense

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

|                             | Year Ended December 31,                |          |      |           |                 |
|-----------------------------|--|----------|------|-----------|-----------------|
|                             | 2015                                   | % Change | 2014 | % Change  | 2013            |
|                             | (In thousands, except percentage data) |          |      |           |                 |
| Sales and marketing expense | \$146,794                              | (6.5     | )%   | \$157,017 | 2.1 % \$153,804 |

## 2015 vs 2014

Sales and marketing expense decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in personnel-related costs of \$6.7 million, driven by a reduction in headcount attributable to the restructuring activities executed in the first quarter of 2015, and \$2.7 million in outside professional services. Headcount decreased by 38 employees to 339 employees at December 31, 2015 compared to 377 employees at December 31, 2014.

We expect our sales and marketing expenses to slightly increase as a percentage of net revenue in the near term. 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 revenues 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 and extent of marketing programs as we introduce new products.

## 2014 vs 2013

Sales and marketing expense increased for the year ended December 31, 2014 compared to the prior year due primarily to an increase of \$1.6 million in personnel-related expense, driven primarily by additional stock-based compensation expense recognized relating to the modification of equity awards in connection with the departure of the retail business unit general manager, \$1.4 million in variable compensation expense, \$1.2 million in marketing

expenses and \$0.7 million in intangibles amortization, partially offset by a decrease of \$2.3 million in projects and professional services. Headcount decreased by 10 employees to 377 employees at December 31, 2014 compared to 387 employees at December 31, 2013.

Table of Contents

## General and Administrative Expense

General and administrative expenses consist 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 and other general corporate expenses. The following table presents general and administrative expense, for the periods indicated:

|                                    | Year Ended December 31,                |          |      |          | 2013 |    |          |
|------------------------------------|--|----------|------|----------|------|----|----------|
|                                    | 2015                                   | % Change | 2014 | % Change |      |    |          |
|                                    | (In thousands, except percentage data) |          |      |          |      |    |          |
| General and administrative expense | \$45,313                               | (2.7     | )%   | \$46,552 | (4.8 | )% | \$48,915 |

## 2015 vs 2014

General and administrative expense decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in facilities, allocation and other expenses of \$2.6 million and outside professional services of \$0.7 million, partially offset by an increase in variable compensation of \$2.2 million. Headcount decreased by 1 employee to 155 employees at December 31, 2015 compared to 156 employees at December 31, 2014.

We expect our general and administrative expenses to slightly increase in absolute dollar value in the near term but they could fluctuate depending on a number of factors, including the level and timing of expenditures associated with the litigation described in Note 9, Commitments and Contingencies, in the Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K. 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.

## 2014 vs 2013

General and administrative expense decreased for the year ended December 31, 2014 compared to the prior year due primarily to a \$3.5 million decrease in outside professional services, primarily resulting from litigation and merger and acquisition services incurred in 2013 that were not repeated in 2014, partially offset by a \$1.3 million increase in variable compensation expense. Headcount increased by 12 employees to 156 employees at December 31, 2014 compared to 144 employees at December 31, 2013.

## Restructuring and Other Charges

|                                 | Year Ended December 31,                |          |      |          | 2013  |    |         |
|---------------------------------|--|----------|------|----------|-------|----|---------|
|                                 | 2015                                   | % Change | 2014 | % Change |       |    |         |
|                                 | (In thousands, except percentage data) |          |      |          |       |    |         |
| Restructuring and other charges | \$6,398                                | 189.6    | )%   | \$2,209  | (58.6 | )% | \$5,335 |

Restructuring and other charges increased for the year ended December 31, 2015 compared to the prior year. Expenses recognized for the year ended December 31, 2015 relate primarily to contract and employee termination charges, as well as other activities attributable to the restructuring actions announced in February 2015 primarily for the service provider business unit. During the year ended December 31, 2014, we recognized a charge of \$1.4 million relating primarily to expenses associated with the early termination of a lease agreement in Canada and a charge of \$0.8 million primarily relating to one-time separation charges associated with the departure of the retail business unit general manager. During the year ended December 31, 2013, we recognized \$3.3 million in one-time separation charges associated with the consolidation of certain teams and locations in effort to drive efficiencies and realign resources to better focus on key growth markets. In addition, we recognized \$1.9 million in transition costs relating to



the AirCard acquisition completed in the second quarter of 2013 and \$0.2 million relating to an office lease exit liability.

In the first fiscal quarter of 2016, we expect to incur restructuring charges of between approximately \$1.5 million and \$2.5 million related to the reduction of the cost structure of the service provider business unit and supporting functions. Such restructuring actions are subject to significant risks, including delays in implementing expense control programs or workforce reductions and the failure to meet operational targets due to the loss of employees, all of which would impair our ability to achieve anticipated cost reductions. If we do not achieve the anticipated cost reductions, our financial results could be negatively impacted.

Litigation Reserves, Net

46

---

Table of Contents

|                                  | Year Ended December 31,                |          |              |          |         |
|----------------------------------|--|----------|--------------|----------|---------|
|                                  | 2015                                   | % Change | 2014         | % Change | 2013    |
|                                  | (In thousands, except percentage data) |          |              |          |         |
| Litigation reserves, net         | \$(2,682 )                             | 165.3    | % \$(1,011 ) | **       | \$5,354 |
| **Percentage data not meaningful |  |          |              |          |         |

We recognized a benefit of \$2.7 million during the year ended December 31, 2015 resulting from adjustments recorded to release litigation reserves previously accrued associated with the Ericsson patent litigation matter. We recognized \$1.0 million benefits in litigation-related reserves during the year ended December 31, 2014 resulting from the adjustments made to decrease the accrued litigation reserves relating to Ericsson after the Federal Circuits issued its opinion and order in our appeal. In contrast, we recognized \$5.4 million expenses during the year ended December 31, 2013 for costs relating primarily to the Ericsson and Ruckus litigation matters.

For a detailed discussion of our litigation matters, refer to Note 9, Commitments and Contingencies, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

## Goodwill Impairment Charges

|                                  | Year Ended December 31,                |           |          |          |      |
|----------------------------------|--|-----------|----------|----------|------|
|                                  | 2015                                   | % Change  | 2014     | % Change | 2013 |
|                                  | (In thousands, except percentage data) |           |          |          |      |
| Goodwill impairment charges      | \$—                                    | (100.0 )% | \$74,196 | **       | \$—  |
| **Percentage data not meaningful |  |           |          |          |      |

We did not recognize a goodwill impairment change during the years ended December 31, 2015 and December 31, 2013. We recognized a goodwill impairment charge of \$74.2 million during the year ended December 31, 2014 related to our service provider business unit. The goodwill impairment was due to a decrease in the estimated fair value of the business resulting from a decline in the long-term revenue and profitability projections of the business.

Refer to Note 3, Balance Sheet Components, for additional information regarding the Company's goodwill impairment assessment.

## Intangibles Impairment Charges

|                                  | Year Ended December 31,                |          |      |           |         |
|----------------------------------|--|----------|------|-----------|---------|
|                                  | 2015                                   | % Change | 2014 | % Change  | 2013    |
|                                  | (In thousands, except percentage data) |          |      |           |         |
| Intangibles impairment charges   | \$—                                    | **       | \$—  | (100.0 )% | \$2,000 |
| **Percentage data not meaningful |  |          |      |           |         |

We did not recognize any intangibles impairment charges during the years ended December 31, 2015 and December 31, 2014. We recorded an intangibles impairment charge of \$2.0 million during the year ended December 31, 2013 relating to the abandonment of certain IPR&D projects acquired in the AirCard acquisition.

Refer to Note 2, Business Acquisitions and the Intangibles section of Note 3, Balance Sheet Components, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K for further discussion.



Table of Contents

## 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, net, for the periods indicated:

|   | Year Ended December 31,                |          | 2014       | % Change | 2013     |
|---|--|----------|------------|----------|----------|
|   | 2015                                   | % Change |            |          |          |
|   | (In thousands, except percentage data) |          |            |          |          |
| Interest income                             | \$295                                  | 16.6     | % \$253    | (36.8    | )% \$400 |
| Other income (expense), net                 | (88                                    | ) **     | 2,455      | **       | (457 )   |
| Total interest income and other income, net | \$207                                  | (92.4    | )% \$2,708 | **       | \$(57 )  |

\*\* Percentage change not meaningful.

## 2015 vs 2014

Total interest income and other income (expense), net, decreased for the year ended December 31, 2015 compared to the prior year. During the year ended December 31, 2014, we recognized income of \$2.8 million relating to the execution of a litigation settlement agreement, which was partially offset by foreign currency losses incurred. In contrast, no significant other income (expense) was recognized during the year ended December 31, 2015.

Interest income and other expense, net will fluctuate due to changes in interest rates and returns on our cash, cash equivalents and short-term investments, any future impairment of investments, foreign currency rate fluctuations on hedged exposures, fluctuations in costs associated with our hedging program, gains and losses on asset disposals and timing of non-income based taxes and license fees. The cash balance could also decrease depending upon the amount of cash used in our stock repurchase activity, any future acquisitions and other factors which would also impact our interest income.

## 2014 vs 2013

Interest income decreased for the year ended December 31, 2014 compared to the prior year due primarily to the decrease in our cash, cash equivalents and short term investment balance attributable to the AirCard and Arada acquisitions completed in the second quarter of 2013 and repurchase of shares in the fourth quarter of 2013 and fiscal year 2014.

Other income (expense), net increased for the year ended December 31, 2014 compared to the prior year due primarily to \$2.8 million received relating to the execution of a litigation settlement agreement during the year, partially offset by foreign currency losses incurred.

## Provision for Income Taxes

|                            | Year Ended December 31,                |          | 2014       | % Change | 2013        |
|----------------------------|--|----------|------------|----------|-------------|
|                            | 2015                                   | % Change |            |          |             |
|                            | (In thousands, except percentage data) |          |            |          |             |
| Provision for income taxes | \$36,980                               | 68.3     | % \$21,973 | (41.8    | )% \$37,765 |
| Effective tax rate         | 43.2                                   | %        | 71.4       | %        | 40.6 %      |

## 2015 vs 2014

Provision for income taxes increased for the year ended December 31, 2015 compared to the prior year due primarily to higher pretax income. The effective tax rate for the year ended December 31, 2015 differed from the U.S. statutory rate of 35% due to earnings from foreign jurisdictions, state taxes, tax credits and non-deductible expenses. The effective tax rate for December 31, 2014 differed from the U.S. statutory rate of 35% due to earnings from foreign jurisdictions, impairment of goodwill not deductible for tax, valuation allowance established to reduce certain deferred tax assets, state taxes, tax credits and non-deductible expenses. For the year ended December 31, 2015, tax on earnings from foreign operations increased the effective tax rate by 7.1 percentage points compared to an increase of 19.8 percentage points for 2014. The decrease in the effective tax rate from earnings of foreign operations in 2015 compared to 2014 resulted from the 2014 tax effect of non-deductible losses caused by the impairment of goodwill in foreign jurisdictions where no benefit can be claimed. The 2015 effective tax rate decreased by 7.8 percentage points when compared to 2014 for the 2014 goodwill impairments that are not deductible for U.S. federal and state tax purposes.

Table of Contents

## 2014 vs 2013

Provision for income taxes decreased for the year ended December 31, 2014 compared to the prior year due primarily to lower pretax income. The effective tax rate for the year ended December 31, 2014 differed from the U.S. statutory rate of 35% due to earnings from foreign jurisdictions, impairment of goodwill not deductible for tax, valuation allowance established to reduce certain deferred tax assets, state taxes, tax credits and non-deductible expenses. The effective tax rate for December 31, 2013 differed from the U.S. statutory rate of 35% due to the same items with the exception of the goodwill impairment and the valuation allowance. For the year ended December 31, 2014, tax on earnings from foreign operations increased the effective tax rate by 19.8 percentage points compared to an increase of 3.9 percentage points for 2013. The increase in the effective tax rate from earnings of foreign operations in 2014 compared to 2013 resulted from the tax effect of non-deductible losses caused by the impairment of goodwill in foreign jurisdictions where no benefit can be claimed. The 2014 effective tax rate was increased by 7.8 percentage points for goodwill impairments that are not deductible for U.S. federal and state tax purposes.

## Segment Information

A description of our products and services, as well as segment financial data, for each segment can be found in Note 12, Segment Information, Operations by Geographic Area and Customer Concentration, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

## Retail

|                           | Year Ended December 31,                |          |             |          |      |           |
|---------------------------|--|----------|-------------|----------|------|-----------|
|                           | 2015                                   | % Change | 2014        | % Change | 2013 |           |
|                           | (in thousands, except percentage data) |          |             |          |      |           |
| Net revenue               | \$614,367                              | 20.9     | % \$508,100 | (0.4     | )%   | \$509,924 |
| Percentage of net revenue | 47.2                                   | %        | 36.5        | %        |      | 37.3      |
| Contribution income       | 85,231                                 | 11.8     | % 76,266    | 3.9      | %    | 73,418    |
| Contribution margin       | 13.9                                   | %        | 15.0        | %        |      | 14.4      |

## 2015 vs 2014

Retail net revenue increased for the year ended December 31, 2015 compared to the prior year due primarily to an increase in gross shipments of home security camera, broadband gateways and home wireless products. In addition, the increase in retail net revenue was due to increasing average selling prices, mainly driven by our Nighthawk and Arlo product lines. Geographically, we experienced growth in the Americas, while net revenue in EMEA declined due primarily to challenges resulting from the macro-economic environment, increased competition and pricing pressures we continue to experience in the region, as well as weakening foreign currencies compared to the U.S. dollar. Net revenue in APAC also declined compared to the prior year period as a result of the strengthening of the U.S. dollar. We continue to see strong end-user demand for our recently introduced retail products, including the Nighthawk series and Arlo Smart Home cameras. Through the year ended December 31, 2015, we have continued to expand our distribution of Arlo with U.S. retail customers and in select international markets, driving sequential gross shipment growth in each of the four quarters of 2015. In contrast, we didn't release the product until December of 2014.

Contribution income increased for the year ended December 31, 2015 compared to the prior year due primarily to the increase in net revenue, partially offset by the negative effects of increases in freight costs of \$5.9 million and operating expenses of \$16.9 million, primarily driven by an increase in research and development expenses.

2014 vs 2013

Retail net revenue decreased for the year ended December 31, 2014 compared to the prior year due primarily to a reduction in gross shipments of our multimedia and powerline products, partially offset by an increase in gross shipments of home wireless products and broadband gateways. Geographically, we experienced an increase in APAC and a decrease in EMEA and the Americas. We continued to see strong end-user demand for our retail products in 2014, however our net revenue was partially constrained by a reduction in weeks of inventory on-hand with our U.S retail channel partners.

Contribution income increased for the year ended December 31, 2014 compared to the prior year due primarily to the reduction of \$4.3 million in operating expenses, primarily driven by a decrease in product marketing expenses.

Table of Contents

## Commercial

|                           | Year Ended December 31,                |          |      |           |       |    |           |
|---------------------------|--|----------|------|-----------|-------|----|-----------|
|                           | 2015                                   | % Change | 2014 | % Change  | 2013  |    |           |
|                           | (in thousands, except percentage data) |          |      |           |       |    |           |
| Net revenue               | \$264,846                              | (13.4)   | )%   | \$305,677 | (1.8) | )% | \$311,261 |
| Percentage of net revenue | 20.4                                   | %        |      | 21.9      | %     |    | 22.7      |
| Contribution income       | 53,393                                 | (24.6)   | )%   | 70,810    | 6.5   | %  | 66,506    |
| Contribution margin       | 20.2                                   | %        |      | 23.2      | %     |    | 21.4      |

## 2015 vs 2014

Commercial net revenue decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in gross shipments of network storage, wireless products and switches. Geographically, we experienced a reduction in EMEA and APAC net revenue and a slight increase in the Americas. Commercial net revenue continued to be impacted by the difficult small business market climate in Europe and by weakening foreign currencies as compared to the U.S. dollar driving increased pricing pressures.

Contribution income decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in net revenue. This effect was further amplified by the reduction in operating expenses occurring at lower rate than the reduction of cost of revenue, primarily driven by an increase in product management and marketing expense of \$1.0 million.

## 2014 vs 2013

Commercial net revenue decreased for the year ended December 31, 2014 compared to the prior year due primarily to a reduction in gross shipments of our network storage and wireless products, partially offset by an increase in shipments of switches. Geographically, we experienced an increase in EMEA and a decrease in the Americas and APAC. Commercial net revenue was negatively impacted by increased competition, particularly in our network storage products.

Contribution income increased for the year ended December 31, 2014 compared to the prior year due primarily to a reduction in freight costs of \$2.4 million and a reduction of \$1.2 million in warranty costs, partially offset by the reduction in net revenue for the year ended December 31, 2014 compared to the prior year.

## Service Provider

|                           | Year Ended December 31,                |          |      |           |       |    |           |
|---------------------------|--|----------|------|-----------|-------|----|-----------|
|                           | 2015                                   | % Change | 2014 | % Change  | 2013  |    |           |
|                           | (in thousands, except percentage data) |          |      |           |       |    |           |
| Net revenue               | \$421,482                              | (27.3)   | )%   | \$579,738 | 5.7   | %  | \$548,448 |
| Percentage of net revenue | 32.4                                   | %        |      | 41.6      | %     |    | 40.0      |
| Contribution income       | 39,151                                 | (17.7)   | )%   | 47,547    | (7.9) | )% | 51,620    |
| Contribution margin       | 9.3                                    | %        |      | 8.2       | %     |    | 9.4       |

## 2015 vs 2014

Service provider net revenue decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in gross shipments in all geographies. As the profit margin of this business unit continued to deteriorate throughout 2014, we decided to restructure the business in the first quarter of 2015 to downsize the net



revenue and cost structure of this business unit while focusing our resources on more profitable accounts and technologies. Service provider net revenue is also negatively impacted by the strengthening of U.S. dollars.

Contribution income decreased for the year ended December 31, 2015 compared to the prior year due primarily to a reduction in net revenue, partially offset by the positive effects of the reduction of operating expenses occurring at higher rate than the reduction of cost of revenue, primarily driven by decreases in research and development of \$14.6 million and in sales and marketing expenses of \$9.4 million. In the second half of 2015, the profit margin of this business unit returned to levels to be successful long term.

Table of Contents

2014 vs 2013

Service provider net revenue increased for the year ended December 31, 2014 compared to the prior year due primarily to an increase in gross shipments of our mobile products. Net revenue for mobile products increased for the year ended December 31, 2014 as a result of the AirCard acquisition which was completed on April 2, 2013. In contrast to 2013, the positive effect of the acquisition is included in our results for the entire year of 2014.

Contribution income decreased for the year ended December 31, 2014 compared to the prior year due primarily to the increase in operating expenses of \$6.4 million, primarily relating to research and development and sales and marketing, and an increase in charges for excess and obsolete inventory. These expenses were partially offset by the increase in gross profit attributable to net revenue growth compared to the prior year.

Liquidity and Capital Resources

As of December 31, 2015, we had cash, cash equivalents and short-term investments totaling \$278.3 million. Our cash and cash equivalents balance increased from \$141.2 million as of December 31, 2014 to \$181.9 million as of December 31, 2015. Our short-term investments, which represent the investment of funds available for current operations, decreased from \$115.9 million as of December 31, 2014 to \$96.3 million as of December 31, 2015, due primarily to the maturity of treasuries being used to fund the repurchase of common stock during the period. Operating activities during the year ended December 31, 2015 generated cash of \$110.4 million, compared to \$109.0 million in 2014, resulting primarily from changes in working capital and in deferred income taxes, offset by a decrease in net income when excluding the \$74.2 million of non-cash goodwill impairment charge. Investing activities during the year ended December 31, 2015 provided cash of \$6.0 million, resulting primarily from net proceeds from the sales and maturities of short term investments, partially offset by purchases of property and equipment. During the year ended December 31, 2015, financing activities used cash of \$75.6 million, primarily due to the repurchase of common stock, partially offset by proceeds from the issuance of common stock upon exercise of stock options and our employee stock purchase program.

Our days sales outstanding ("DSO") increased from 73 days as of December 31, 2014 to 77 days as of December 31, 2015. The increase is mainly due to extension of credits to retailers for holiday selling seasons, and our sales to retailers increased significantly during the 2015 holiday season compared to the 2014 holiday season.

Our accounts payable decreased from \$106.4 million at December 31, 2014 to \$90.5 million at December 31, 2015, primarily as a result of timing of payments.

Inventory decreased from \$222.9 million at December 31, 2014 to \$213.1 million at December 31, 2015. Ending inventory turns increased to 4.8 turns in the three months ended December 31, 2015, up from 4.5 turns in the three months ended December 31, 2014.

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

accumulated other comprehensive income until the related revenue, costs of revenue, or expenses are recognized.

## Table of Contents

On October 21, 2008, October 17, 2014 and July 21, 2015, our Board of Directors authorized management to repurchase up to 6.0 million, 3.0 million and 3.0 million shares of our outstanding common stock, respectively, which, at the time of authorization, were incremental to the remaining shares under the share repurchase programs. Under the authorizations, we may repurchase shares of our common stock, depending on market conditions, in the open market or through privately negotiated transactions. The timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and the price of our common stock. As of December 31, 2015, the share repurchase programs authorized prior to July 2015 have been completed and there were 2.2 million shares remaining in the buyback program. We repurchased, reported based on trade date, approximately 3.8 million shares of common stock at a cost of \$117.7 million during the year ended December 31, 2015. During the years ended December 31, 2014 and December 31, 2013, we repurchased, reported based on trade date, approximately 2.8 million shares of common stock at a cost of \$90.6 million and approximately 2.0 million shares of common stock at a cost of \$63.1 million, respectively.

We also repurchased, as reported based on trade date, approximately 85,000 shares of common stock at a cost of \$2.6 million, under a repurchase program to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the year ended December 31, 2015. Similarly, during the years ended December 31, 2014 and December 31, 2013, we repurchased, as reported on trade date, approximately 82,000 shares of common stock at a cost of \$2.6 million and 14,000 shares of common stock at a cost of \$0.5 million, respectively, under the same program to help facilitate tax withholding for RSUs.

These shares were retired upon repurchase. Our 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.

Based on our current plans and market conditions, we believe that our existing cash, cash equivalents and short-term investments will be sufficient to satisfy our anticipated cash requirements for 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.

## Backlog

As of December 31, 2015, we had a backlog of approximately \$115.6 million, compared to approximately \$114.6 million as of December 31, 2014, primarily due to product demand required in the future. Our backlog consists of products for which customer purchase orders have been received and that are scheduled or in the process of being scheduled for shipment. While we expect to fulfill the order backlog within the current year, most orders are subject to rescheduling or cancellation with minimal penalties. Because of the possibility of customer changes in product scheduling or order cancellation, our backlog as of any particular date may not be an indicator of net revenue for any succeeding period.

## Contractual Obligations and Off-Balance Sheet Arrangements

### Contractual Obligations

Edgar Filing: NETGEAR, INC - Form 10-K

The following table describes our commitments to settle non-cancelable lease and purchase commitments as of December 31, 2015 (in thousands).

|                      | Less Than<br>1 Year | 1-3<br>Years | 3-5<br>Years | More Than<br>5 Years | Total     |
|----------------------|---------------------|--------------|--------------|----------------------|-----------|
| Operating leases     | \$8,429             | \$11,359     | \$10,746     | \$23,209             | \$53,743  |
| Purchase obligations | 132,819             | —            | —            | —                    | 132,819   |
|                      | \$141,248           | \$11,359     | \$10,746     | \$23,209             | \$186,562 |

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense in the years ended December 31, 2015, 2014, and 2013 was \$9.8 million, \$10.8 million and \$9.9 million, respectively. The terms of some of the office leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period, and have accrued for rent expense incurred but not paid. The amounts

## Table of Contents

presented are consistent with contractual terms and are not expected to differ significantly, unless a substantial change in our headcount needs requires us to exit an office facility early or expand our occupied space.

We enter into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of the orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are not cancelable within 30 days prior to the expected shipment date. At December 31, 2015, we had \$132.8 million in non-cancelable purchase commitments with suppliers. We expect to sell all products for which we have committed purchases from suppliers.

As of December 31, 2015 and December 31, 2014, we had \$15.8 million and \$16.3 million, respectively, of total 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 statement of operations in the next 12 months is approximately \$0.6 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

### Off-Balance Sheet Arrangements

As of December 31, 2015, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

### Recent Accounting Pronouncements

See Note 1, The Company and Summary of Significant Accounting Policies, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on financial condition and results of operations, which are hereby incorporated by reference.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

### Interest Rate Risk

We do not use derivative financial instruments in our investment portfolio. We have an investment portfolio of fixed income securities that are classified as available-for-sale securities. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in highly rated short-term securities. Our investment policy requires investments to be rated triple-A with the objective of minimizing the potential risk of principal loss. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% by market interest rates would not have a material impact on our operating results and the total value of the portfolio over the next fiscal year. We monitor our interest rate and credit risks, including our credit exposure to specific rating categories and to individual issuers. There were no impairment charges on our investments during fiscal 2015.

### Foreign Currency Transaction Risk

We invoice some of our international customers in foreign currencies including, but not limited to, the Australian dollar, British pound, euro, Canadian dollar, and Japanese yen. As the customers that are currently invoiced in local currency become a larger percentage of our business, or to the extent we begin to bill additional customers in foreign

currencies, the impact of fluctuations in foreign exchange rates could have a more significant impact on our results of operations. For those customers in our international markets that we continue to sell to in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand for our products could reduce sales and negatively impact our operating results. Certain operating expenses of our foreign operations require payment in the local currencies.

We are exposed to risks associated with foreign exchange rate fluctuations due to our international sales and operating activities. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. We use foreign currency forward contract derivatives to partially offset our business exposure to foreign exchange risk on our foreign currency denominated assets and liabilities. Additionally, we enter into certain foreign currency forward contracts that have been designated as cash flow hedges under the authoritative guidance for derivatives and hedging to

Table of Contents

partially offset our business exposure to foreign exchange risk on portions of our anticipated foreign currency revenue, costs of revenue, and certain operating expenses. The objective of these foreign currency forward contracts is to reduce the impact of currency exchange rate movements on our operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The contracts are marked-to-market on a monthly basis with gains and losses included in other income (expense), net in the consolidated statements of operations, and in accumulated other comprehensive income on the consolidated balance sheets. We do not use foreign currency contracts for speculative or trading purposes. Hedging of our balance sheet and anticipated cash flow exposures may not always be effective to protect us against currency exchange rate fluctuations. In addition, we do not fully hedge our balance sheet and anticipated cash flow exposures, leaving us at risk to foreign exchange gains and losses on the un-hedged exposures. If there were an adverse movement in exchange rates, we might suffer significant losses. See Note 5, Derivative Financial Instruments, of the Notes to Consolidated Financial Statements for additional disclosure on our foreign currency contracts, which are hereby incorporated by reference into this Part II, Item 7A.

As of December 31, 2015, we had net assets in various local currencies. A hypothetical 10% movement in foreign exchange rates would result in an after-tax positive or negative impact of \$0.7 million net income, net of our hedged position, at December 31, 2015. Actual future gains and losses associated with our foreign currency exposures and positions may differ materially from the sensitivity analyses performed as of December 31, 2015 due to the inherent limitations associated with predicting the foreign currency exchange rates, and our actual exposures and positions. For the year ended December 31, 2015, 20% of total net revenue was denominated in a currency other than the U.S. dollar.



Table of Contents

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a) (1) present fairly, in all material respects, the financial position of NETGEAR, Inc. and its subsidiaries at December 31, 2015 and December 31, 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

/s/ PricewaterhouseCoopers LLP  
San Jose, CA  
February 19, 2016

55

---

Table of Contents

NETGEAR, INC.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|  | As of<br>December 31,<br>2015 | December 31,<br>2014 |
|--|-------------------------------|----------------------|
| <b>ASSETS</b>  |                               |                      |
| Current assets:  |                               |                      |
| Cash and cash equivalents  | \$181,945                     | \$141,234            |
| Short-term investments   | 96,321                        | 115,895              |
| Accounts receivable, net   | 290,642                       | 275,689              |
| Inventories  | 213,118                       | 222,883              |
| Deferred income taxes  | —                             | 29,039               |
| Prepaid expenses and other current assets  | 39,117                        | 38,225               |
| Total current assets   | 821,143                       | 822,965              |
| Property and equipment, net  | 22,384                        | 29,694               |
| Intangibles, net   | 48,947                        | 66,230               |
| Goodwill   | 81,721                        | 81,721               |
| Other non-current assets   | 76,374                        | 48,077               |
| Total assets   | \$1,050,569                   | \$1,048,687          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                               |                      |
| Current liabilities:   |                               |                      |
| Accounts payable   | \$90,546                      | \$106,357            |
| Accrued employee compensation  | 27,868                        | 21,588               |
| Other accrued liabilities  | 166,282                       | 143,742              |
| Deferred revenue   | 29,125                        | 30,023               |
| Income taxes payable   | 1,951                         | 2,406                |
| Total current liabilities  | 315,772                       | 304,116              |
| Non-current income taxes payable   | 14,444                        | 15,252               |
| Other non-current liabilities  | 11,643                        | 7,754                |
| Total liabilities  | 341,859                       | 327,122              |
| Commitments and contingencies (Note 9)   |                               |                      |
| Stockholders' equity:  |                               |                      |
| Preferred stock: \$0.001 par value; 5,000,000 shares authorized; none issued or outstanding  | —                             | —                    |
| Common stock: \$0.001 par value; 200,000,000 shares authorized; shares issued and outstanding: 32,600,990 and 34,709,022 at December 31, 2015 and 2014, respectively | 33                            | 35                   |
| Additional paid-in capital   | 513,047                       | 454,144              |
| Accumulated other comprehensive income   | 3                             | 38                   |
| Retained earnings  | 195,627                       | 267,348              |
| Total stockholders' equity   | 708,710                       | 721,565              |
| Total liabilities and stockholders' equity   | \$1,050,569                   | \$1,048,687          |

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



Table of Contents

NETGEAR, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|   | Year Ended December 31, |             |             |
|---|-------------------------|-------------|-------------|
|   | 2015                    | 2014        | 2013        |
| Net revenue   | \$1,300,695             | \$1,393,515 | \$1,369,633 |
| Cost of revenue   | 933,016                 | 995,597     | 976,018     |
| Gross profit  | 367,679                 | 397,918     | 393,615     |
| Operating expenses:   |                         |             |             |
| Research and development                                      | 86,499                  | 90,902      | 85,168      |
| Sales and marketing   | 146,794                 | 157,017     | 153,804     |
| General and administrative                                    | 45,313                  | 46,552      | 48,915      |
| Restructuring and other charges                               | 6,398                   | 2,209       | 5,335       |
| Litigation reserves, net                                      | (2,682)                 | ) (1,011)   | ) 5,354     |
| Goodwill impairment charges                                   | —                       | 74,196      | —           |
| Intangibles impairment charges                                | —                       | —           | 2,000       |
| Total operating expenses                                      | 282,322                 | 369,865     | 300,576     |
| Income from operations  | 85,357                  | 28,053      | 93,039      |
| Interest income   | 295                     | 253         | 400         |
| Other income (expense), net                                   | (88)                    | ) 2,455     | (457)       |
| Income before income taxes                                    | 85,564                  | 30,761      | 92,982      |
| Provision for income taxes                                    | 36,980                  | 21,973      | 37,765      |
| Net income  | \$48,584                | \$8,788     | \$55,217    |
| Net income per share:   |                         |             |             |
| Basic   | \$1.47                  | \$0.25      | \$1.44      |
| Diluted   | \$1.44                  | \$0.24      | \$1.42      |
| Weighted average shares used to compute net income per share: |                         |             |             |
| Basic   | 33,161                  | 35,771      | 38,379      |
| Diluted   | 33,788                  | 36,445      | 38,948      |

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

Table of Contents

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

|  | Year Ended December 31, |         |          |   |
|--|-------------------------|---------|----------|---|
|  | 2015                    | 2014    | 2013     |   |
| Net income   | \$48,584                | \$8,788 | \$55,217 |   |
| Other comprehensive income (loss), before tax:             |                         |         |          |   |
| Unrealized gain (loss) on derivative instruments           | —                       | (22     | ) 89     |   |
| Unrealized loss on available-for-sale securities           | (56                     | ) (14   | ) (40    | ) |
| Other comprehensive income (loss), before tax              | (56                     | ) (36   | ) 49     |   |
| Tax benefit related to items of other comprehensive income | 21                      | 5       | 16       |   |
| Other comprehensive income (loss), net of tax              | (35                     | ) (31   | ) 65     |   |
| Comprehensive income                                       | \$48,549                | \$8,757 | \$55,282 |   |

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

Table of Contents

NETGEAR, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

|   | Common Stock |        | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings | Total     |
|---|--------------|--------|----------------------------------|--|----------------------|-----------|
|   | Shares       | Amount |                                  |  |                      |           |
| Balance at December 31,<br>2012   | 38,342       | \$38   | \$394,427                        | \$ 4   | \$360,142            | \$754,611 |
| Change in unrealized<br>gains and losses on<br>available-for-sale<br>securities, net of tax | —            | —      | —                                | (24 )  | —                    | (24 )     |
| Change in unrealized<br>gains and losses on<br>derivatives, net of tax                      | —            | —      | —                                | 89   | —                    | 89        |
| Net income  | —            | —      | —                                | —  | 55,217               | 55,217    |
| Stock-based<br>compensation expense   | —            | —      | 17,419                           | —  | —                    | 17,419    |
| Purchase and retirement<br>of common stock  | (2,018 )     | (1 )   | —                                | —  | (63,583 )            | (63,584 ) |
| Issuance of common stock<br>under stock-based<br>compensation plans                         | 516          | —      | 9,626                            | —  | —                    | 9,626     |
| Tax impact from exercises<br>and cancellations of stock<br>options                          | —            | —      | 429                              | —  | —                    | 429       |
| Balance at December 31,<br>2013   | 36,840       | 37     | 421,901                          | 69   | 351,776              | 773,783   |
| Change in unrealized<br>gains and losses on<br>available-for-sale<br>securities, net of tax | —            | —      | —                                | (9 )   | —                    | (9 )      |
| Change in unrealized<br>gains and losses on<br>derivatives, net of tax                      | —            | —      | —                                | (22 )  | —                    | (22 )     |
| Net income  | —            | —      | —                                | —  | 8,788                | 8,788     |
| Stock-based<br>compensation expense   | —            | —      | 19,983                           | —  | —                    | 19,983    |
| Purchase and retirement<br>of common stock  | (2,908 )     | (2 )   | —                                | —  | (93,216 )            | (93,218 ) |
| Issuance of common stock<br>under stock-based<br>compensation plans                         | 777          | —      | 12,741                           | —  | —                    | 12,741    |
| Tax impact from exercises<br>and cancellations of stock<br>options                          | —            | —      | (481 )                           | —  | —                    | (481 )    |

Edgar Filing: NETGEAR, INC - Form 10-K

|  |          |      |           |       |            |            |
|--|----------|------|-----------|-------|------------|------------|
| Balance at December 31, 2014   | 34,709   | 35   | 454,144   | 38    | 267,348    | 721,565    |
| Change in unrealized gains and losses on available-for-sale securities, net of tax | —        | —    | —         | (35 ) | —          | (35 )      |
| Change in unrealized gains and losses on derivatives, net of tax                   | —        | —    | —         | —     | —          | —          |
| Net income   | —        | —    | —         | —     | 48,584     | 48,584     |
| Stock-based compensation expense   | —        | —    | 16,813    | —     | —          | 16,813     |
| Purchase and retirement of common stock  | (3,855 ) | (4 ) | —         | —     | (120,305 ) | (120,309 ) |
| Issuance of common stock under stock-based compensation plans                      | 1,747    | 2    | 44,323    | —     | —          | 44,325     |
| Tax impact from exercises and cancellations of stock options                       | —        | —    | (2,233 )  | —     | —          | (2,233 )   |
| Balance at December 31, 2015   | 32,601   | \$33 | \$513,047 | \$ 3  | \$195,627  | \$708,710  |

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



Table of Contents

NETGEAR, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | Year Ended December 31, |             |             |
|---|-------------------------|-------------|-------------|
|   | 2015                    | 2014        | 2013        |
| Cash flows from operating activities:   |                         |             |             |
| Net income  | \$48,584                | \$8,788     | \$55,217    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |             |             |
| Depreciation and amortization   | 35,850                  | 35,590      | 32,854      |
| Purchase premium amortization/discount accretion on investments, net              | (57)                    | ) 11        | 1,103       |
| Non-cash stock-based compensation   | 16,825                  | 20,014      | 17,462      |
| Income tax impact associated with stock option exercises                          | (2,233)                 | ) (481)     | ) 429       |
| Excess tax benefit from stock-based compensation                                  | (759)                   | ) (485)     | ) (767)     |
| Goodwill impairment charges   | —                       | 74,196      | —           |
| Intangibles impairment charges  | —                       | —           | 2,000       |
| Deferred income taxes   | (710)                   | ) (20,261)  | ) (7,927)   |
| Changes in assets and liabilities, net of effect of acquisitions:                 |                         |             |             |
| Accounts receivable   | (14,952)                | ) (9,205)   | ) (10,470)  |
| Inventories   | 9,765                   | 1,573       | (46,679)    |
| Prepaid expenses and other assets   | 560                     | (7,905)     | (4,615)     |
| Accounts payable  | (14,990)                | ) (8,236)   | ) 36,250    |
| Accrued employee compensation   | 6,280                   | 5,037       | (1,787)     |
| Other accrued liabilities   | 29,987                  | 2,574       | 15,069      |
| Deferred revenue  | (2,496)                 | ) 5,188     | (1,211)     |
| Income taxes payable  | (1,263)                 | ) 2,566     | (26)        |
| Net cash provided by operating activities   | 110,391                 | 108,964     | 86,902      |
| Cash flows from investing activities:   |                         |             |             |
| Purchases of short-term investments   | (110,316)               | ) (145,186) | ) (153,464) |
| Proceeds from sales and maturities of short-term investments                      | 130,273                 | 134,827     | 275,406     |
| Purchase of property and equipment  | (14,000)                | ) (19,338)  | ) (18,050)  |
| Payments for patents  | —                       | —           | (275)       |
| Proceeds from sale of cost method investments                                     | —                       | —           | 3,890       |
| Payments made in connection with business acquisitions, net of cash acquired      | —                       | (1,050)     | (147,240)   |
| Net cash provided by (used in) investing activities                               | 5,957                   | (30,747)    | (39,733)    |
| Cash flows from financing activities:   |                         |             |             |
| Purchase and retirement of common stock   | (120,309)               | ) (93,218)  | ) (63,585)  |
| Proceeds from exercise of stock options   | 40,928                  | 9,979       | 7,487       |
| Proceeds from issuance of common stock under employee stock purchase plan         | 2,985                   | 2,762       | 2,139       |
| Excess tax benefit from stock-based compensation                                  | 759                     | 485         | 767         |
| Net cash used in financing activities   | (75,637)                | ) (79,992)  | ) (53,192)  |
| Net increase (decrease) in cash and cash equivalents                              | 40,711                  | (1,775)     | (6,023)     |
| Cash and cash equivalents, at beginning of year                                   | 141,234                 | 143,009     | 149,032     |
| Cash and cash equivalents, at end of year   | \$181,945               | \$141,234   | \$143,009   |
| Supplemental Cash Flow Information:   |                         |             |             |
| Cash paid for income taxes  | \$40,273                | \$38,938    | \$45,982    |

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

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Summary of Significant Accounting Policies

The Company

NETGEAR, Inc. (“NETGEAR” or the “Company”) was incorporated in Delaware in January 1996. The Company is a global networking company that delivers innovative products to consumers, businesses and service providers. 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 wired and wireless devices that enable networking, broadband access and network connectivity. These products are available in multiple configurations to address the needs of the end-users in each geographic region in which the Company's products are sold.

The Company operates in three specific business segments: retail, commercial, and service provider. The Company believes this structure enables it to better focus its efforts on the Company's core customer segments and allows it to be more nimble and opportunistic as a company overall. Each business unit contains leadership focused on the product development efforts, both from a product marketing and engineering standpoint, to service the unique needs of these customer segments. The retail business unit is focused on individual consumers and consists of high performance, dependable and easy-to-use home networking, home video security, storage and digital media products. The commercial business unit is focused on small and medium-sized businesses and consists of business networking, storage and security solutions that bring enterprise class functionality at an affordable price. The service provider business unit is focused on the service provider market and consists of made-to-order and retail-proven whole home networking hardware and software solutions, as well as 4G LTE hotspots sold to service providers for sale to their subscribers.

The Company sells networking products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers (“DMRs”), value-added resellers (“VARs”), and broadband service providers.

Basis of presentation

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

Fiscal periods

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

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

#### Cash and cash equivalents

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

#### Short-term investments

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

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Short-term investments are also comprised of marketable securities related to deferred compensation under the Company's Deferred Compensation Plan. Mutual funds are the only investments allowed in the Company's Deferred Compensation Plan and the investments are held in a grantor trust formed by the Company. The Company has classified these investments as trading securities as the grantor trust actively manages the asset allocation to match the participants' notional fund allocations. These securities are recorded at fair market value with unrealized gains and losses included in other income (expense), net.

Certain risks and uncertainties

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

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

Derivative financial instruments

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

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

Concentration of credit risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, short-term investments and accounts receivable. The Company believes that there is minimal credit risk associated with the investment of its cash and cash equivalents and short-term investments, due to the restrictions

placed on the type of investment that can be entered into under the Company's investment policy. The Company's short-term investments consist of investment-grade securities, and the Company's cash and investments are held and managed by recognized financial institutions.

The Company's customers are primarily distributors as well as retailers and broadband service providers who sell or distribute the products to a large group of end-users. The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The Company regularly performs credit evaluations of the Company's customers' financial condition and considers factors such as historical experience, credit quality, age of the accounts receivable balances, geographic or country-specific risks and current economic conditions that may affect customers' ability to pay. The Company does not require collateral from its customers. The Company secures credit insurance for certain customers in international and domestic markets.

As of December 31, 2015 and December 31, 2014, Best Buy, Inc. accounted for 37% and 21% of the Company's total accounts receivable, respectively, and no other customers accounted for 10% or greater of the Company's total accounts receivable.

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

Fair value measurements

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

Cost method investments

The Company's cost method investments are included in other non-current assets in the consolidated balance sheets and are carried at cost, adjusted for any impairment, because the Company does not have a controlling interest and does not have the ability to exercise significant influence over these companies. The Company monitors these investments for impairment on a quarterly basis, and adjusts carrying value for any impairment charges recognized. Realized gains and losses on these investments are reported in other income (expense), net in the consolidated statements of operations.

Allowance for doubtful accounts

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

Inventories

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

Property and equipment, net

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

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

Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both



Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

internal and external, that may suggest impairment. Charges related to the impairment of property and equipment were insignificant for the years ended December 31, 2015, 2014 and 2013.

Goodwill

Goodwill represents the purchase price over estimated fair value of net assets of businesses acquired in a business combination. Goodwill acquired in a business combination is not amortized, but instead tested for impairment at least annually on the first day of the fourth quarter. Should certain events or indicators of impairment occur between annual impairment tests, the Company performs the impairment test as those events or indicators occur. Examples of such events or circumstances include the following: a significant decline in the Company's expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in the business climate; and slower growth rates.

Goodwill is tested for impairment at the reporting unit level by first performing a qualitative assessment to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of the reporting unit is less than its carrying value. The Company identified the reporting units as retail, commercial and service provider reporting units, as this is the lowest level for which discrete financial information is available and segment management regularly reviews the operating results. The qualitative assessment considers the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in the Company's share price. If the reporting unit does not pass the qualitative assessment, the Company estimates its fair value and compares the fair value with the carrying value of its net assets. If the fair value is greater than the carrying value of its net assets, no impairment is recorded. If the fair value is less than its carrying value, the Company would determine the fair value of the goodwill by comparing the implied fair value to the carrying value of the goodwill in the same manner as if the reporting unit were being acquired in a business combination. Specifically, the Company would allocate the fair value to all of its assets and liabilities, including any unrecognized intangibles, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded to earnings in the consolidated statements of operations.

We did not recognize any goodwill impairment charges during the years ended December 31, 2015 and 2013 and recorded a goodwill impairment charge of \$74.2 million which was the entire goodwill balance related to the service provider reporting unit.

Intangibles, net

Purchased intangibles with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from four to ten years. Finite-lived intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition.

In the fourth quarter of fiscal year 2015, the Company saw a decline in net revenue in the service provider reporting unit. According to its customers, purchase constraints will tighten further in 2016 and for the foreseeable future. Due to the decline in the long-term revenue and profit outlook, the Company performed the recoverability test of the long-lived assets within the service provider reporting unit. The Company estimated the undiscounted future cash flows directly associated with each asset group and compared the amounts to the carrying value of each asset group. Based on the results of the recoverability test, the sum of undiscounted future cash flows was greater than the carrying

value of each asset group and therefore no impairment was recorded. The Company also reviewed the depreciation and amortization policies for the long-lived asset groups and ensured the remaining useful lives are appropriate.

Purchased intangibles determined to have indefinite useful lives are not amortized. Indefinite-lived intangibles are reviewed for impairment at least annually during the fourth quarter and whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Measurement of an impairment loss for indefinite-lived assets that management expects to hold and use is based on the fair value of the asset. Indefinite-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

In the third quarter of 2013, the Company recorded an impairment charge of \$2.0 million related to the abandonment of certain IPR&D projects obtained in the AirCard acquisition in 2013. As of the end of the second quarter of 2014, all of the remaining IPR&D had reached technical feasibility and was reclassified to definite-lived intangibles with an estimated useful life of four years. No other impairments to long-lived assets were recognized in the years ended December 31, 2015, 2014 and 2013.

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Warranty obligations

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

Revenue recognition

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

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

When applying the relative selling price method, the Company determines the selling price for each deliverable using vendor-specific objective evidence ("VSOE") of fair value of the deliverable, or when VSOE of fair value is unavailable, its best estimate of selling price ("ESP"), as the Company has determined it is unable to establish third-party evidence of selling price for the deliverables. In determining VSOE, the Company requires that a substantial majority of the selling prices for a deliverable sold on a stand-alone basis fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical stand-alone transactions falling within +/-15% of the median price. The Company determines ESP for a deliverable by considering multiple factors

including, but not limited to, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The objective of ESP is to determine the price at which the Company would transact a sale if the deliverable were sold on a stand-alone basis. The determination of ESP is made through consultation with and formal approval by the Company's management, taking into consideration the go-to-market strategy.

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

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Sales incentives

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

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

Shipping and handling fees and costs

The Company includes shipping and handling fees billed to customers in net revenue. Shipping and handling costs associated with inbound freight are included in cost of revenue. In cases where the Company gives a freight allowance to the customer for their own inbound freight costs, such costs are appropriately recorded as a reduction in net revenue. Shipping and handling costs associated with outbound freight are included in sales and marketing expenses and totaled \$10.4 million, \$10.5 million and \$11.6 million in the years ended December 31, 2015, 2014 and 2013 respectively.

Research and development

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

Advertising costs

Advertising costs are expensed as incurred. Total advertising and promotional expenses were \$19.4 million, \$19.1 million, and \$18.0 million in the years ended December 31, 2015, 2014 and 2013 respectively.

Income taxes

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

In the ordinary course of business there is inherent uncertainty in assessing the Company's income tax positions. The Company assesses its tax positions and records benefits for all years subject to examination based on management's evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company records the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax

benefit will be sustained, no tax benefit has been recorded in the financial statements. Where applicable, associated interest and penalties have also been recognized as a component of income tax expense.

#### Net income per share

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

#### Stock-based compensation

The Company measures stock-based compensation at the grant date based on the fair value of the award. The fair value of stock options is estimated using the Black-Scholes option pricing model. Estimated compensation cost relating to restricted stock

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

units ("RSUs") is based on the closing fair market value of the Company's common stock on the date of grant. The fair value of Employee Stock Purchase Plan ("ESPP") is based on the 15% discount at purchase, since the price of the shares is determined at the purchase date.

The compensation expense for equity awards is reduced by an estimate for forfeitures and is recognized over the vesting period of the award under a graded vesting method. In addition, the Company will recognize an excess benefit from stock-based compensation in equity based on the difference between tax expense computed with consideration of the windfall deduction and without consideration of the windfall deduction. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit and the foreign tax credit in the income statement. See Note 11, Employee Benefit Plans, of the Notes to Consolidated Financial Statements for a further discussion on stock-based compensation.

#### Comprehensive income

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

#### Foreign currency translation and re-measurement

The Company's functional currency is the U.S. dollar for all of its international subsidiaries. Foreign currency transactions of international subsidiaries are re-measured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for non-monetary assets. Expenses are re-measured at average exchange rates in effect during each period, except for expenses related to non-monetary assets, which are re-measured at historical exchange rates. Revenue is re-measured at average exchange rates in effect during each period. Gains and losses arising from foreign currency transactions are included in other income (expense), net.

#### Recent accounting pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customer" (Topic 606). The guidance in this update supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. An entity should apply the amendments in the update either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. On July 9, 2015, the FASB concluded to delay the effective date of the new revenue standard by one year. ASU 2014-09 is effective for the Company beginning in the first quarter fiscal 2018. Early adoption is permitted but may not occur earlier than January 1, 2017, the original effective date of the standard for the Company. The Company is in the process of evaluating the available transition methods and the impact of this standard on its financial position, results of operations or cash flows.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory" (Topic 330). The new guidance changes the subsequent measurement of inventory from lower of cost or market to lower of cost and net realizable value. ASU 2015-11 should be applied on a prospective basis and is effective for the Company beginning in the first fiscal quarter of 2017. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material impact on its financial position, results of operations or cash flows.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes" (Topic 740), which simplifies the presentation of deferred income taxes. This ASU requires that deferred tax assets and liabilities be classified as non-current in a statement of financial position. ASU 2015-17 may be adopted either prospectively or retrospectively and is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company elected early adoption ASU 2015-17 effective December 31, 2015 on a prospective basis. Adoption of this ASU resulted in a reclassification of our net current deferred tax asset to the net non-current deferred tax asset in our Consolidated Balance Sheet as of December 31, 2015. No prior periods were retrospectively adjusted.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)". The changes to the current US GAAP financial instruments model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial



Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

instruments. The Company is currently evaluating what impact, if any, the adoption of this standard will have on its results of its financial position, results of operations or cash flows.

## Note 2. Business Acquisitions

## Arada Systems, Inc.

On June 21, 2013, the Company acquired certain assets and operations of Arada Systems, Inc. ("Arada"), a privately-held company that develops, licenses, and provides solutions for the next generation of uses of Wi-Fi, for total purchase consideration of \$5.3 million in cash. The Company believes the acquisition will bolster its wireless product offerings in its commercial business unit and strengthen its position in the small to medium-sized campus wireless LAN market. The Company paid \$4.2 million of the aggregate purchase price in the second quarter of 2013, and paid the remaining \$1.1 million in the second quarter of 2014.

The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of Arada have been included in the 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.

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

|                             |         |
|-----------------------------|---------|
| Property and equipment, net | \$ 15   |
| Intangibles, net            | 4,040   |
| Goodwill                    | 1,195   |
| Total purchase price        | \$5,250 |

Of the \$1.2 million of goodwill recorded on the acquisition of Arada, approximately \$0.7 million and \$1.2 million are deductible for U.S. federal and state income tax purposes, respectively. The goodwill recognized, which was assigned to the Company's commercial business unit, is primarily attributable to expected synergies resulting from the acquisition.

The Company designated \$4.0 million of the acquired intangibles as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 21.5%. The acquired existing technology is being amortized over an estimated useful life of five years.

## AirCard Division of Sierra Wireless, Inc.

On April 2, 2013, the Company completed the acquisition of select assets and operations of the Sierra Wireless, Inc. AirCard business ("AirCard"), including customer relationships, a world-class LTE engineering team, certain intellectual property, inventory and property and equipment. The Company believes this acquisition will accelerate the mobile initiative of the service provider business unit to become a global leader in providing the latest in LTE data networking access devices.

The Company paid \$140.0 million of the aggregate purchase price in the second quarter of 2013. The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of AirCard have been included in the consolidated financial statements since the date of acquisition. Revenue and earnings for AirCard as of the acquisition date are not presented as the business was fully integrated into the service provider business unit subsequent to the acquisition and therefore impracticable for the Company to quantify.

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

|   |          |
|---|----------|
| Inventories                               | \$2,874  |
| Prepaid expenses and other current assets | 12,256   |
| Property and equipment, net               | 7,455    |
| Intangibles, net                          | 69,700   |
| Goodwill                                  | 53,841   |
| Liabilities assumed                       | (6,096 ) |

Total purchase price

\$140,030

68

---

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In the third quarter of 2013, the Company made an adjustment of \$0.5 million to goodwill related to revised inventory estimates.

Of the \$53.8 million of goodwill recorded on the acquisition of AirCard, approximately \$35.8 million, \$53.8 million and \$2.3 million is deductible for U.S. federal, U.S. state and Canadian income tax purposes, respectively. The goodwill recognized, which was assigned to the Company's service provider business unit, is primarily attributable to expected synergies resulting from the acquisition.

The Company designated \$16.3 million of the acquired intangibles as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 10.0%. The acquired technology is being amortized over an estimated useful life of four years.

The Company designated \$40.5 million of the acquired intangibles as customer relationships. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to existing customer relationships and discounted at 12.0%. The acquired customer relationships are being amortized over an estimated useful life of eight years.

The Company designated \$2.3 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 12.0%. The acquired agreements are being amortized over an estimated useful life of five years.

The Company designated \$1.1 million of the acquired intangibles as backlog. The value was calculated based on the present value of the future contractual revenue and discounted at 10.0%. The acquired backlog was fully amortized in the second quarter of 2013.

The Company acquired \$9.5 million in in-process research and development ("IPR&D") projects. The value was calculated based on the present value of future estimated cash flows discounted at 13.0%, derived from projections of future revenues attributable to the assets, expected economic life of the assets, and royalty rates. IPR&D acquired is considered indefinite lived intangibles until research and development efforts associated with the projects are completed or abandoned. The most significant of the acquired IPR&D projects relate to multimode LTE technologies, Mobile Hot Spot, USB dongle, and Module form factors. During the third quarter of 2013, the Company recorded an intangibles impairment charge of \$2.0 million related to the abandonment of certain IPR&D projects previously acquired. As of the end of the second quarter of 2014, \$7.5 million of the acquired IPR&D had reached technical feasibility and was reclassified to definite-lived intangibles and with an estimated useful life of four years.

## Pro forma financial information

The unaudited pro forma financial information in the table below summarizes the combined results of our operations and those of AirCard for the periods shown as though the acquisition of AirCard occurred as of the beginning of the fiscal year 2012. The pro forma financial information for the periods presented includes the accounting effects of the business combination, including adjustments to the amortization of intangibles, fair value of acquired inventory, acquisition-related costs, integration expenses and related tax effects of these adjustments, where applicable. This information is for informational purposes only, is subject to a number of estimates, assumptions and other uncertainties, and may not be indicative of the results of operations that would have been achieved if the acquisition had taken place at January 1, 2012.

The unaudited pro forma financial information is as follows (in thousands):

|             | Year Ended December<br>31, 2013<br>(in millions) |
|-------------|--|
| Net revenue | \$1,415  |
| Net income  | \$57   |



Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Note 3. Balance Sheet Components (in thousands)

## Available-for-sale short-term investments

|                             | As of<br>December 31, 2015 |                    |                    |                         | December 31, 2014 |                    |                    |                         |
|-----------------------------|----------------------------|--------------------|--------------------|-------------------------|-------------------|--------------------|--------------------|-------------------------|
|                             | Cost                       | Unrealized<br>Gain | Unrealized<br>Loss | Estimated<br>Fair Value | Cost              | Unrealized<br>Gain | Unrealized<br>Loss | Estimated<br>Fair Value |
| U.S. treasuries             | \$95,057                   | \$1                | \$(65 )            | \$94,993                | \$114,944         | \$6                | \$(15 )            | \$114,935               |
| Certificates of<br>deposits | 147                        | —                  | —                  | 147                     | 158               | —                  | —                  | 158                     |
| Total                       | \$95,204                   | \$1                | \$(65 )            | \$95,140                | \$115,102         | \$6                | \$(15 )            | \$115,093               |

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 12 months.

## Cost method investments

The carrying value of the Company's cost method investments was \$0.1 million and \$1.3 million for the years ended December 31, 2015 and December 31, 2014. These investments are included in other non-current assets in the consolidated balance sheets and are carried at cost, adjusted for any impairment, because the Company does not have a controlling interest and does not have the ability to exercise significant influence over these companies. The Company monitors these investments for impairment on a quarterly basis, and adjusts carrying value for any impairment charges recognized. There were no impairments recognized in the years ended December 31, 2015, December 31, 2014 and December 31, 2013. Realized gains and losses on these investments are reported in other income (expense), net in the consolidated statements of operations. No material gains or losses were recorded in the years ended December 31, 2015, 2014 and 2013.

## Accounts receivable, net

|                                 | As of                |                      |
|---------------------------------|----------------------|----------------------|
|                                 | December 31,<br>2015 | December 31,<br>2014 |
| Gross accounts receivable       | \$309,926            | \$296,239            |
| Allowance for doubtful accounts | (1,255 )             | (1,255 )             |
| Allowance for sales returns     | (15,904 )            | (17,489 )            |
| Allowance for price protection  | (2,125 )             | (1,806 )             |
| Total allowances                | (19,284 )            | (20,550 )            |
| Total accounts receivable, net  | \$290,642            | \$275,689            |

## Inventories

|                 | As of                |                      |
|-----------------|----------------------|----------------------|
|                 | December 31,<br>2015 | December 31,<br>2014 |
| Raw materials   | \$4,292              | \$3,625              |
| Work-in-process | 2                    | 8                    |
| Finished goods  | 208,824              | 219,250              |

|                   |           |           |
|-------------------|-----------|-----------|
| Total inventories | \$213,118 | \$222,883 |
|-------------------|-----------|-----------|

The Company records provisions for excess and obsolete inventory based on forecasts of future demand. 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.

70

---

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Property and equipment, net

|  | As of                |                      |
|--|----------------------|----------------------|
|  | December 31,<br>2015 | December 31,<br>2014 |
| Computer equipment                             | \$11,161             | \$9,779              |
| Furniture, fixtures and leasehold improvements | 18,317               | 19,379               |
| Software                                       | 30,396               | 29,294               |
| Machinery and equipment                        | 66,662               | 60,135               |
| Total property and equipment, gross            | 126,536              | 118,587              |
| Accumulated depreciation and amortization      | (104,152 )           | (88,893 )            |
| Total property and equipment, net              | \$22,384             | \$29,694             |

Depreciation and amortization expense pertaining to property and equipment was \$18.1 million, \$17.6 million and \$17.3 million for the years ended December 31, 2015, 2014 and 2013, respectively.

## Intangibles, net

The following tables present details of the Company's purchased intangibles:

|                                      | Gross     | Accumulated<br>Amortization | Net      |
|--------------------------------------|-----------|-----------------------------|----------|
| December 31, 2015                    |           |                             |          |
| Technology                           | \$61,099  | \$(48,485 )                 | \$12,614 |
| Customer contracts and relationships | 56,500    | (23,290 )                   | 33,210   |
| Other                                | 10,545    | (7,422 )                    | 3,123    |
| Total intangibles, net               | 128,144   | (79,197 )                   | 48,947   |
| December 31, 2014                    |           |                             |          |
| Technology                           | \$61,099  | \$(39,341 )                 | \$21,758 |
| Customer contracts and relationships | 56,500    | (16,205 )                   | 40,295   |
| Other                                | 10,545    | (6,368 )                    | 4,177    |
| Total intangibles, net               | \$128,144 | \$(61,914 )                 | \$66,230 |

Amortization of purchased intangibles in the years ended December 31, 2015, 2014 and 2013 was \$17.3 million, \$17.9 million and \$15.5 million, respectively. In the year ended December 31, 2013, the Company recorded an impairment charge of \$2.0 million due to the abandonment of IPR&D acquired as part of the AirCard acquisition. No impairment charges were recorded in the years ended December 31, 2015 and 2014.

Estimated amortization expense related to finite-lived intangibles for each of the next five years and thereafter is as follows:

| Year Ended December 31, | Amount   |
|-------------------------|----------|
| 2016                    | \$16,921 |
| 2017                    | 11,386   |
| 2018                    | 7,871    |
| 2019                    | 6,028    |
| 2020                    | 5,316    |

|                                     |          |
|-------------------------------------|----------|
| Thereafter                          | 1,425    |
| Total expected amortization expense | \$48,947 |

71

---



Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Goodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2015 and 2014 are as follows:

|                               | Retail   | Commercial | Service<br>Provider | Total     |
|-------------------------------|----------|------------|---------------------|-----------|
| Goodwill at December 31, 2013 | \$45,442 | \$ 36,279  | \$74,196            | \$155,916 |
| Goodwill impairment charges   | —        | —          | (74,196)            | (74,196)  |
| Goodwill at December 31, 2014 | 45,442   | \$ 36,279  | —                   | 81,721    |
| Goodwill impairment charges   | —        | —          | —                   | —         |
| Goodwill at December 31, 2015 | \$45,442 | \$ 36,279  | \$—                 | \$81,721  |

In the fourth fiscal quarter of 2015, the Company completed the annual impairment test of goodwill. The test was performed as of the first day of the fourth quarter.

The Company performed a qualitative test for goodwill impairment of the retail and commercial reporting units as of September 28, 2015. Based upon the results of the qualitative testing, the respective fair values of the retail and commercial reporting units were substantially in excess of these reporting units' carrying values. The Company believes it is more-likely-than-not that the fair value of these reporting units are greater than their respective carrying values and therefore performing the first step of the two-step impairment test for the retail and commercial reporting units was unnecessary. No goodwill impairment was recognized for the retail and commercial reporting units in the years ended December 31, 2015, 2014 or 2013.

In the fourth quarter of fiscal year 2014, the Company recorded a goodwill impairment charge of \$74.2 million related to the service provider reporting unit in the year ended December 31, 2014.

There were no impairments to goodwill in the years ended December 31, 2015 and 2013. Accumulated goodwill impairment charges for the years ended December 31, 2015 and 2014, was \$74.2 million and \$74.2 million, respectively.

## Other non-current assets

|                                   | As of<br>December 31,<br>2015 | December 31,<br>2014 |
|-----------------------------------|-------------------------------|----------------------|
| Non-current deferred income taxes | \$68,445                      | * \$38,696           |
| Cost method investments           | 105                           | 1,322                |
| Other                             | 7,824                         | 8,059                |
| Total other non-current assets    | \$76,374                      | \$48,077             |

\* Includes a reclassification of the net current deferred tax asset to the net non-current deferred tax asset in the consolidated Balance Sheet as of December 31, 2015. No prior periods were retrospectively adjusted. Refer to Note 1, The Company and Summary of Significant Accounting Policies, for additional information regarding the early adoption of the ASU 2015-17.

## Other accrued liabilities

|                              | As of<br>December 31,<br>2015 | December 31,<br>2014 |
|------------------------------|-------------------------------|----------------------|
| Sales and marketing programs | \$69,693                      | \$54,582             |

|                                 |           |           |
|---------------------------------|-----------|-----------|
| Warranty obligation             | 56,706    | 44,888    |
| Freight                         | 5,748     | 6,827     |
| Other                           | 34,135    | 37,445    |
| Total other accrued liabilities | \$166,282 | \$143,742 |

Note 4. Restructuring and Other Charges

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

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

During the year ended December 31, 2015, the Company incurred restructuring and other charges of \$6.4 million. Restructuring charges recognized are primarily related to contract and employee termination charges, as well as other activities attributable to the restructuring actions announced in February 2015. During the year ended December 31, 2014, the Company incurred restructuring charges of \$2.2 million. The Company recognized a charge of \$1.4 million relating primarily to expenses associated with the early termination of a lease agreement in Canada and \$0.8 million relating to one-time separation costs, primarily relating to the departure of the general manager of the retail business unit in the first quarter of 2014.

The following tables provide a summary of accrued restructuring and other charges activity for the years ended December 31, 2015 and 2014:

|                              | Restructuring  | Acquisition      | Total   |
|------------------------------|----------------|------------------|---------|
|                              | (in thousands) | transition costs |         |
| Balance at December 31, 2013 | \$1,013        | \$10             | \$1,023 |
| Additions                    | 2,228          | 6                | 2,234   |
| Cash payments                | (2,901)        | (16)             | (2,917) |
| Adjustments                  | (24)           | —                | (24)    |
| Balance at December 31, 2014 | 316            | —                | 316     |
| Additions (a)                | 5,946          | —                | 5,946   |
| Cash payments                | (5,736)        | —                | (5,736) |
| Balance at December 31, 2015 | \$526          | \$—              | \$526   |

(a) Total restructuring and other charges recognized in the Company's consolidated statement of operations for the year ended December 31, 2015 includes non-cash charges and adjustments, net of \$0.5 million. These amounts have been excluded from the table above.

## Note 5. 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 six months and the Company continuously evaluates the credit standing of its counter-party financial institutions. The counter-parties to these arrangements are large highly rated financial institutions and the Company does not consider non-performance a material risk.

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

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The fair values of the Company's derivative instruments and the line items on the consolidated balance sheet to which they were recorded as of December 31, 2015, and December 31, 2014, are summarized as follows (in thousands):

| Derivative Assets  | Balance Sheet Location                    | Fair value at December 31, 2015 | Balance Sheet Location                    | Fair value at December 31, 2014 |
|--|---|---------------------------------|---|---------------------------------|
| Derivative assets not designated as hedging instruments      | Prepaid expenses and other current assets | \$3,203                         | Prepaid expenses and other current assets | \$2,416                         |
| Derivative assets designated as hedging instruments          | Prepaid expenses and other current assets | 2                               | Prepaid expenses and other current assets | —                               |
| Total  |   | \$3,205                         |   | \$2,416                         |
| Derivative Liabilities                                       | Balance Sheet Location                    | Fair value at December 31, 2015 | Balance Sheet Location                    | Fair value at December 31, 2014 |
| Derivative liabilities not designated as hedging instruments | Other accrued liabilities                 | \$447                           | Other accrued liabilities                 | \$409                           |
| Derivative liabilities designated as hedging instruments     | Other accrued liabilities                 | 4                               | Other accrued liabilities                 | 38                              |
| Total  |   | \$451                           |   | \$447                           |

For details of the Company's fair value measurements, see Note 13, Fair Value Measurements.

## 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 consolidated balance sheets.

The following tables set forth the offsetting of derivative assets as of December 31, 2015 and December 31, 2014 (in thousands):

| As of December 31, 2015 | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts Of Assets Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets |                         | Net Amount |
|-------------------------|------------------------------------|---|--|---|-------------------------|------------|
|                         |                                    |   |  | Financial Instruments                                       | Cash Collateral Pledged |            |
| Barclays                | \$577                              | \$—   | \$577  | \$(56)  | ) \$—                   | \$521      |
| Wells Fargo             | 2,628                              | —   | 2,628  | (395)   | ) —                     | 2,233      |
| Total                   | \$3,205                            | \$—   | \$3,205  | \$(451)   | ) \$—                   | \$2,754    |

Edgar Filing: NETGEAR, INC - Form 10-K

As of December  
31, 2014

|             | Gross Amounts Not Offset in<br>the Consolidated Balance<br>Sheets |   |  |                          |                               |            |
|-------------|---|---|--|--------------------------|-------------------------------|------------|
|             | Gross<br>Amounts of<br>Recognized<br>Assets                       | Gross<br>Amounts<br>Offset in the<br>Consolidated<br>Balance Sheets | Net Amounts Of<br>Assets<br>Presented in the<br>Consolidated<br>Balance Sheets | Financial<br>Instruments | Cash<br>Collateral<br>Pledged | Net Amount |
| Barclays    | \$319   | \$—   | \$319  | \$(16                    | ) \$—                         | \$303      |
| Wells Fargo | 2,097   | —   | 2,097  | (431                     | ) —                           | 1,666      |
| Total       | \$2,416   | \$—   | \$2,416  | \$(447                   | ) \$—                         | \$1,969    |

74

---

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables set forth the offsetting of derivative liabilities as of December 31, 2015 and December 31, 2014 (in thousands):

| As of December 31, 2015 | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts Of Liabilities Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets |                         | Net Amount |
|-------------------------|---|---|---|---|-------------------------|------------|
|                         |   |   |   | Financial Instruments                                       | Cash Collateral Pledged |            |
| Barclays                | \$56                                    | \$—   | \$56  | \$(56)  | ) \$—                   | \$—        |
| Wells Fargo             | 395                                     | —   | 395   | (395)   | ) —                     | —          |
| Total                   | \$451                                   | \$—   | \$451   | \$(451)   | ) \$—                   | \$—        |

| As of December 31, 2014 | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts Of Liabilities Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets |                         | Net Amount |
|-------------------------|---|---|---|---|-------------------------|------------|
|                         |   |   |   | Financial Instruments                                       | Cash Collateral Pledged |            |
| Barclays                | \$16                                    | \$—   | \$16  | \$(16)  | ) \$—                   | \$—        |
| Wells Fargo             | 431                                     | —   | 431   | (431)   | ) —                     | —          |
| Total                   | \$447                                   | \$—   | \$447   | \$(447)   | ) \$—                   | \$—        |

## 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 for three to five months. The Company enters into about five forward contracts per quarter with an average size of approximately \$7 million USD equivalent related to its cash flow hedging program.

The Company expects to reclassify to earnings all of the amounts recorded in OCI associated with its cash flow hedges over the next 12 months. OCI associated with cash flow hedges of foreign currency revenue is recognized as a component of net revenue in the same period as the related revenue is recognized. 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 expense in the same period 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 associated with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in the fair

value of such derivative instruments are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the years ended December 31, 2015, 2014 and 2013.



Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The effects of the Company's derivative instruments on OCI and the consolidated statement of operations for the years ended December 31, 2015, 2014 and 2013 are summarized as follows (in thousands):

| Year Ended December 31, 2015                  |   |   |   |  |  |
|---|---|---|---|--|--|
| Derivatives Designated as Hedging Instruments | Gain (Loss) Recognized in OCI - Effective Portion (a) | Location of Gain (Loss) Reclassified from OCI into Income - Effective Portion | Gain (Loss) Reclassified from OCI into Income - Effective Portion (a) | Location of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing | Amount of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing |
| Cash flow hedges:                             |   |   |   |  |  |
| Foreign currency forward contracts            | \$453   | Net revenue   | \$462   | Other income (expense), net  | \$(52)   |
| Foreign currency forward contracts            | —   | Cost of revenue   | 6   | Other income (expense), net  | —  |
| Foreign currency forward contracts            | —   | Operating expenses  | (15)  | Other income (expense), net  | —  |
| Total   | \$453   |   | \$453   |  | \$(52)   |
| Year Ended December 31, 2014                  |   |   |   |  |  |
| Derivatives Designated as Hedging Instruments | Gain (Loss) Recognized in OCI - Effective Portion (a) | Location of Gain (Loss) Reclassified from OCI into Income - Effective Portion | Gain (Loss) Reclassified from OCI into Income - Effective Portion (a) | Location of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing | Amount of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing |
| Cash flow hedges:                             |   |   |   |  |  |
| Foreign currency forward contracts            | \$292   | Net revenue   | \$459   | Other income (expense), net  | \$ (144)   |
| Foreign currency forward contracts            | —   | Cost of revenue   | 4   | Other income (expense), net  | —  |
| Foreign currency forward contracts            | —   | Operating expenses  | (149)   | Other income (expense), net  | —  |
| Total   | \$292   |   | \$314   |  | \$ (144)   |
| Year Ended December 31, 2013                  |   |   |   |  |  |
| Derivatives Designated as Hedging Instruments | Gain (Loss) Recognized in OCI - Effective Portion (a) | Location of Gain (Loss) Reclassified from OCI into Income - Effective Portion | Gain (Loss) Reclassified from OCI into Income - Effective Portion (a) | Location of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing | Amount of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing |
| Cash flow hedges:                             |   |   |   |  |  |
| Foreign currency forward contracts            | \$775   | Net revenue   | \$844   | Other income (expense), net  | \$ (117)   |

Edgar Filing: NETGEAR, INC - Form 10-K

|                                    |       |                    |       |   |                             |           |
|------------------------------------|-------|--------------------|-------|---|-----------------------------|-----------|
| Foreign currency forward contracts | —     | Cost of revenue    | (9    | ) | Other income (expense), net | —         |
| Foreign currency forward contracts | —     | Operating expenses | (149  | ) | Other income (expense), net | —         |
| Total                              | \$775 |                    | \$686 |   |                             | \$ (117 ) |

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

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 years ended December 31, 2015, 2014 and 2013.

## 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 15 non-designated derivatives per quarter. The average size of its non-designated hedges is approximately \$2 million USD equivalent and these hedges normally range from one to five months in duration.

The effects of the Company's derivatives not designated as hedging instruments in other income (expense), net in the consolidated statements of operations for the years ended December 31, 2015, 2014 and 2013, are as follows (in thousands):

| Derivatives Not Designated as Hedging Instruments | Location of Gains (Losses) Recognized in Income on Derivative | Amount of Gains (Losses) Recognized in Income on Derivative |       |       |
|---|---|---|-------|-------|
|   |   | Year ended December 31,                                     |       |       |
|   |   | 2015  | 2014  | 2013  |
| Foreign currency forward contracts                | Other income (expense), net                                   | 4,956   | 4,897 | \$458 |

## Note 6. Net Income Per Share

Basic net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. Potentially dilutive common shares include outstanding stock options and unvested restricted stock awards, which are reflected in diluted net income per share by application of the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of stock-based compensation cost for future services that the Company has not yet recognized, and the estimated tax benefit that would be recorded in additional paid-in capital upon exercise are assumed to be used to repurchase shares.

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Net income per share for the years ended December 31, 2015, 2014 and 2013 are as follows (in thousands, except per share data):

|   | Year Ended           |                      |                      |
|---|----------------------|----------------------|----------------------|
|   | December 31,<br>2015 | December 31,<br>2014 | December 31,<br>2013 |
| Numerator:  |                      |                      |                      |
| Net income  | \$48,584             | \$8,788              | \$55,217             |
| Denominator:  |                      |                      |                      |
| Weighted average common shares - basic              | 33,161               | 35,771               | 38,379               |
| Potentially dilutive common share equivalent        | 627                  | 674                  | 569                  |
| Weighted average common shares - dilutive           | 33,788               | 36,445               | 38,948               |
| Basic net income per share                          | \$1.47               | \$0.25               | \$1.44               |
| Diluted net income per share                        | \$1.44               | \$0.24               | \$1.42               |
| Anti-dilutive employee stock-based awards, excluded | 1,807                | 2,617                | 2,846                |

## Note 7. Other Income (Expense), Net

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

|  | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2015                    | 2014       | 2013       |
| Foreign currency transaction loss, net | \$(5,114)               | ) \$(5,642 | ) \$(1,592 |
| Foreign currency contract gain, net    | 4,904                   | 4,753      | 341        |
| Gain on litigation settlements         | —                       | 2,800      | —          |
| Other                                  | 122                     | 544        | 794        |
| Total                                  | \$(88                   | ) \$2,455  | ) \$(457   |

## Note 8. Income Taxes

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

|               | Year Ended December 31, |          |          |
|---------------|-------------------------|----------|----------|
|               | 2015                    | 2014     | 2013     |
| United States | \$88,681                | \$25,152 | \$91,318 |
| International | (3,117                  | ) 5,609  | 1,664    |
| Total         | \$85,564                | \$30,761 | \$92,982 |

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

|              | Year Ended December 31, |           |          |
|--------------|-------------------------|-----------|----------|
|              | 2015                    | 2014      | 2013     |
| Current:     |                         |           |          |
| U.S. Federal | \$30,970                | \$29,089  | \$30,989 |
| State        | 3,139                   | 2,873     | 3,751    |
| Foreign      | 6,105                   | 10,930    | 11,224   |
|              | 40,214                  | 42,892    | 45,964   |
| Deferred:    |                         |           |          |
| U.S. Federal | (2,645                  | ) (20,347 | ) (6,741 |
| State        | 134                     | (326      | ) (1,164 |
| Foreign      | (723                    | ) (246    | ) (294   |
|              | (3,234                  | ) (20,919 | ) (8,199 |
| Total        | \$36,980                | \$21,973  | \$37,765 |

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

|                                  | Year Ended December 31, |          |   |
|----------------------------------|-------------------------|----------|---|
|                                  | 2015                    | 2014     |   |
| Deferred Tax Assets:             |                         |          |   |
| Accruals and allowances          | \$29,279                | \$25,756 |   |
| Net operating loss carryforwards | 5,353                   | 6,210    |   |
| Stock-based compensation         | 9,895                   | 12,416   |   |
| Deferred rent                    | 2,740                   | 2,137    |   |
| Deferred revenue                 | 1,185                   | 1,654    |   |
| Tax credit carryforwards         | 2,262                   | 1,769    |   |
| Acquired intangibles             | 22,778                  | 21,916   |   |
| Other                            | —                       | 142      |   |
| Total deferred tax assets        | 73,492                  | 72,000   |   |
| Deferred Tax Liabilities:        |                         |          |   |
| Depreciation and amortization    | (967                    | ) (1,245 | ) |
| Other                            | (438                    | ) —      | ) |
| Total deferred tax liabilities   | (1,405                  | ) (1,245 | ) |
| Valuation Allowance**:           | (3,642                  | ) (3,020 | ) |
| Net deferred tax assets          | \$68,445                | \$67,735 |   |
| Current portion                  | \$—                     | \$29,039 |   |
| Non-current portion              | 68,445                  | * 38,696 |   |
| Net deferred tax assets          | \$68,445                | \$67,735 |   |

\* This includes a reclassification of the net current deferred tax asset to the net non-current deferred tax asset in the consolidated Balance Sheet as of December 31, 2015. No prior periods were retrospectively adjusted. Refer to Note 1, The Company and Summary of Significant Accounting Policies, for additional information regarding the early adoption of the ASU 2015-17.

\*\* Valuation allowance is presented gross. The valuation allowance net of the federal tax effect is (\$2,367) and (\$1,963) for the years ended December 31, 2015 and December 31, 2014, respectively.



Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Management's judgment is required in determining the Company's provision for income taxes, its deferred tax assets and any valuation allowance recorded against its deferred tax assets. As of December 31, 2015, a valuation allowance of \$3.6 million was placed against California deferred tax assets since the recovery of the assets is uncertain. There was a valuation allowance of \$3.0 million placed against deferred tax assets as of December 31, 2014. Accordingly, the valuation allowance increased \$0.6 million during 2015. In management's judgment it is more likely than not that the remaining deferred tax assets will be realized in the future as of December 31, 2015, and as such no valuation allowance has been recorded against the remaining deferred tax assets.

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

|                                    | Year Ended December 31, |         |         |    |
|------------------------------------|-------------------------|---------|---------|----|
|                                    | 2015                    | 2014    | 2013    |    |
| Tax at federal statutory rate      | 35.0                    | % 35.0  | % 35.0  | %  |
| State, net of federal benefit      | 2.6                     | % 2.5   | % 2.2   | %  |
| Impact of international operations | 7.1                     | % 19.8  | % 3.9   | %  |
| Stock-based compensation           | (0.4                    | )% 5.5  | % 1.8   | %  |
| Tax credits                        | (1.2                    | )% (3.8 | )% (1.9 | )% |
| Valuation allowance                | —                       | % 3.5   | % —     | %  |
| Goodwill impairment                | —                       | % 7.8   | % —     | %  |
| Others                             | 0.1                     | % 1.1   | % (0.4  | )% |
| Provision for income taxes         | 43.2                    | % 71.4  | % 40.6  | %  |

Income tax benefits (detriments) in the amount of \$(2.2) million, \$(0.5) million and \$0.4 million related to stock options were credited to additional paid-in capital during the years ended December 31, 2015, 2014, and 2013, respectively. As a result of changes in fair value of available for sale securities, income tax benefit of \$21,000, \$5,000 and \$16,000 were recorded in comprehensive income related to the years ended December 31, 2015, 2014, and 2013, respectively.

As of December 31, 2015, the Company has approximately \$15.3 million and \$50,000 of acquired federal and state net operating loss carry forwards as well as \$2.3 million of California tax credits carryforwards. All of these losses are subject to annual usage limitations under Internal Revenue Code Section 382. The federal losses expire in different years beginning in fiscal 2021. The state loss begins to expire in fiscal 2017. The state tax credit carryforwards have no expiration.

The Company files income tax returns in the U.S. federal jurisdiction and various state, local, and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, or local income tax examinations for years before 2009. The Company is no longer subject to foreign income tax examinations before 2004. In November 2012, the Italian Tax Authority (ITA) commenced an audit of the Company's 2004 through 2011 tax years, and has subsequently extended audit procedures to include the 2012 tax year. The Company is currently in litigation with the ITA with respect to all of these years. In April 2015, the German Tax Authority commenced an examination of the Company's 2008 and 2013 tax years. The examination is ongoing. The Company has limited audit activity in various states and other foreign jurisdictions. Due to the uncertain nature of ongoing tax audits, the Company has recorded its liability for uncertain tax positions as part of its long-term liability as payments cannot be anticipated over the next 12 months. The existing tax positions of the Company continue to generate an increase in the liability for uncertain tax positions. The liability for uncertain tax positions may be reduced for liabilities that are settled with taxing authorities or on which the statute of limitations could expire without assessment from tax authorities. The possible reduction in liabilities for uncertain tax positions resulting from the expiration of statutes of limitation in multiple jurisdictions in the next 12 months is approximately \$0.6 million, excluding the interest,

penalties and the effect of any related deferred tax assets or liabilities.

80

---



Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

|  | Federal, State, and<br>Foreign Tax |   |
|--|------------------------------------|---|
| Gross UTB Balance at December 31, 2012                       | \$ 12,339                          |   |
| Additions based on tax positions related to the current year | 1,866                              |   |
| Additions for tax positions of prior years                   | 4,106                              |   |
| Settlements  | (3,134                             | ) |
| Reductions for tax positions of prior years                  | (1,163                             | ) |
| Reductions due to lapse of applicable statutes               | (1,314                             | ) |
| Adjustments due to foreign exchange rate movement            | 43                                 |   |
| Gross UTB Balance at December 31, 2013                       | 12,743                             |   |
| Additions based on tax positions related to the current year | 1,894                              |   |
| Additions for tax positions of prior years                   | 1,722                              |   |
| Settlements  | (503                               | ) |
| Reductions for tax positions of prior years                  | (152                               | ) |
| Reductions due to lapse of applicable statutes               | (1,838                             | ) |
| Adjustments due to foreign exchange rate movement            | (502                               | ) |
| Gross UTB Balance at December 31, 2014                       | \$ 13,364                          |   |
| Additions based on tax positions related to the current year | 1,608                              |   |
| Additions for tax positions of prior years                   | 228                                |   |
| Settlements  | (199                               | ) |
| Reductions for tax positions of prior years                  | (302                               | ) |
| Reductions due to lapse of applicable statutes               | (1,053                             | ) |
| Adjustments due to foreign exchange rate movement            | (816                               | ) |
| Gross UTB Balance at December 31, 2015                       | 12,830                             |   |

The total amount of net UTB that, if recognized would affect the effective tax rate as of December 31, 2015 is \$11.3 million. The ending net UTB results from adjusting the gross balance at December 31, 2015 for items such as U.S. federal and state deferred tax, foreign tax credits, interest, and deductible taxes. The net UTB is included as a component of non-current income taxes payable within the consolidated balance sheet.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the years ended December 31, 2015, 2014, and 2013, total interest and penalties expensed were \$0.1 million, \$1.1 million and \$0.4 million, respectively. As of December 31, 2015 and 2014, accrued interest and penalties on a gross basis was \$3.1 million and \$3.0 million, respectively. Included in accrued interest are amounts related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility.

With the exception of those foreign sales subsidiaries for which deferred tax has been provided, the Company intends to indefinitely reinvest foreign earnings. These earnings were approximately \$136.9 million and \$78.3 million as of December 31, 2015 and December 31, 2014, respectively. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the income tax liability that would be payable if such earnings were not indefinitely reinvested.

Note 9. Commitments and Contingencies

Leases

The Company leases office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense in the years ended, December 31, 2015, 2014, and 2013 was \$9.8 million, \$10.8 million and \$9.9 million, respectively. The terms of some of the Company's office leases provide for rental payments on a graduated scale.

81

---

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

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

|                              |          |
|------------------------------|----------|
| Year Ending December 31,     |          |
| 2016                         | \$8,429  |
| 2017                         | 5,761    |
| 2018                         | 5,598    |
| 2019                         | 5,342    |
| 2020                         | 5,404    |
| Thereafter                   | 23,209   |
| Total minimum lease payments | \$53,743 |

## Employment Agreements

The Company has signed various employment agreements with key executives pursuant to which, if their employment is terminated without cause, such employees are entitled to receive their base salary (and commission or bonus, as applicable) for 52 weeks (for the Chief Executive Officer), 39 weeks (for the Senior Vice President of Worldwide Operations and Support) and up to 26 weeks (for other key executives). Such employees will also continue to have stock options vest for up to a one-year period following such termination without cause. If a termination without cause or resignation for good reason occurs within one year of a change in control, such employees are entitled to full acceleration (for the Chief Executive Officer) and up to two years acceleration (for other key executives) of any unvested portion of his or her equity awards. The Company has no liabilities recorded for these agreements as of December 31, 2015.

## Purchase Obligations

The Company has entered into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. At December 31, 2015, the Company had approximately \$133 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 obligations

Changes in the Company's warranty liability, which is included as a component of "Other accrued liabilities" in the consolidated balance sheets, are as follows (in thousands):

|   |                         |           |           |
|---|-------------------------|-----------|-----------|
|   | Year Ended December 31, |           |           |
|   | 2015                    | 2014      | 2013      |
| Balance at the beginning of the year                    | \$44,888                | \$48,754  | \$46,659  |
| Provision for warranty obligations made during the year | 80,085                  | 62,709    | 69,755    |
| Settlements made during the year                        | (68,267                 | ) (66,575 | ) (67,660 |

|                            |          |          |          |
|----------------------------|----------|----------|----------|
| Balance at the end of year | \$56,706 | \$44,888 | \$48,754 |
|----------------------------|----------|----------|----------|

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Guarantees and Indemnifications

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a Director and Officer Insurance Policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of each indemnification agreement is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2015.

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties. The terms of these indemnification agreements are generally perpetual any time after execution of the agreement. The maximum amount of potential future indemnification is unlimited. The Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2015.

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 alleges that the Company and the other defendants have infringed and continue to infringe the Ericsson patents through the defendants' IEEE 802.11-compliant products. In addition, Ericsson alleged that the Company infringed the claimed methods and apparatuses of the '468 Patent through the Company's PCMCIA routers.

The Company filed its answer to the Ericsson complaint on December 17, 2010 where it asserted the affirmative defenses of noninfringement and invalidity of the asserted patents. On June 8, 2011, Ericsson filed an amended complaint that added Dell, Toshiba and Belkin as defendants. At the status conference held on June 9, 2011, the Court set a Markman (claim construction) hearing for June 28, 2012 and trial for June 3, 2013. On June 21, 2012, Ericsson dismissed the '468 Patent (“Multi-purpose base station”) with prejudice and gave the Company a covenant not to sue as to products in the marketplace now or in the past. On June 22, 2012, Intel filed its Complaint in Intervention, meaning that Intel became an official defendant in the Ericsson case. During the exchange of the expert reports, Ericsson dropped the '516 Patent (the OFDM “pulse shaping” patent). In addition, Ericsson dropped the '223 Patent (packet discard patent) against all the defendants' products, except for those products that use Intel chips. Thus, Ericsson has now dropped the '468 Patent (wireless base station), the '516 Patent (OFDM pulse shaping), and the '223 Patent (packet discard patent) for all non-Intel products.

A jury trial in the Ericsson case 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

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 cent per patent).

On December 16, 2013, the Company and defendants submitted their appeal brief to the Federal Circuit. Ericsson filed its response brief on February 20, 2014, and the defendants filed their reply brief before on March 24, 2014. The oral arguments before the Federal Circuit took place on June 5, 2014.

On December 4, 2014, the Federal Circuit issued its opinion and order in the Company's Ericsson appeal. The Federal Circuit vacated the entirety of the \$3.6 million jury verdict against the Company and the ongoing 15 cent per unit royalty verdict, and also vacated the entirety of the verdict against the other defendants and their ongoing royalties, finding that the District Court hadn't properly instructed the jury on royalty rates and Ericsson's licensing promises. The Federal Circuit held that the lower court had failed to adequately instruct the jury about Ericsson's actual commitments to license the infringed patents on reasonable and nondiscriminatory ("RAND") terms. Further, the Federal Circuit stated that the lower court had neglected to inform the jury that a royalty for a patented technology must be removed from the value of the entire standard, and that a RAND royalty rate should be based on the invention's value, rather than any added value from standardization. The jury's damages awards were therefore completely vacated, and the case was remanded for further proceedings.

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.

In September of 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 at trial -- claim 1 of the '625 Patent, claims 1 and 5 of the '568 Patent, and claims 1 and 2 of the '215 Patent -- ruling these claims were anticipated or obvious in light of prior art. The PTAB also rejected two motions to amend by Ericsson, which sought to substitute certain proposed claims in the '625 and '568 patents, should they be found unpatentable by the PTAB. 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. Ericsson appealed the PTAB decision to the Federal Circuit and also requested that the PTAB reconsider its decision, but the PTAB denied Ericsson's request for reconsideration. While Ericsson appeals the PTAB decision the present status of the case is that the Company does not infringe on any valid Ericsson patent, and accordingly the Company reversed the accruals related to this case in the first fiscal quarter of 2015.

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

In November 2012, the Italian tax police began a comprehensive tax audit of NETGEAR International, Inc.'s Italian Branch. The scope of the audit initially was from 2004 through 2011 and was subsequently expanded to include 2012. The tax audit encompasses 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 (Tax Court) 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 November 7, 2014. The Tax Court found 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. With respect to 2005 through 2007, the Company filed its briefs with the Tax Court in mid-February. In June, 2015, the Company filed with the Provincial Tax Court of Milan (Tax Court) a Request for Hearing in Open Court and Request for Suspension of the Tax Assessment for the 2005 through 2007 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 was held in December 2015 and we are awaiting a decision from the court. With respect to 2008 through 2010, the Company filed its briefs with the Tax Court in October 2015. With respect to 2011 through 2012, the Company plans to file its briefs with the Tax Court to contest this assessment. It is too early to reasonably estimate any financial impact to the Company resulting from this litigation matter.



Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 5, 2015, the Court set the claim construction hearing for December 4, 2015 and allowed discovery for claim construction purposes to commence. 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. Discovery in the case was stayed until the Court issues its claim construction order. 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.

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

Wetro Lan v. NETGEAR, Inc.

On January 30, 2015, the Company was sued by a non-practicing entity called Wetro Lan LLC (“Wetro Lan”) in United States District Court, Eastern District of Texas, Marshall Division. Wetro Lan alleges direct infringement by the Company of United States Patent No. 6,795,918 (the “918 Patent”) entitled “Service Level Computer Security” based on the Company’s manufacture and selling of the “NETGEAR WGR614v9 Wireless Router and similarly situated NETGEAR, Inc. Wireless Routers.” On April 13, 2015 the Company answered the complaint. The Company denied that it infringed the patent and asserted several affirmative defenses (counterclaims), including noninfringement, invalidity, limitation of damages, laches, waiver, estoppel, and other equitable defenses, and on May 4, 2015 Wetro Lan answered the Company’s counterclaims.

On July 16, 2015, the Company filed with the Court a motion to transfer venue from the Eastern District of Texas to the Northern District of California. On August 17, 2015, Wetro Lan filed with the Court its opposition to the Company's motion to transfer venue, and on August 24, 2015 the Company filed its Reply in Support of Transfer as filed. In November 2015, Wetro Lan filed a notice requesting a scheduling conference from which deadlines in the case arise. On January 29, 2016, the Court issued an order consolidating twenty Wetro Lan cases, including the case against the Company for all pretrial issues, except for venue. In the lead case, Wetro Lan v. ADTRAN (No. 2:15-cv-00041), the Court has not yet issued any docket control order or set any scheduling conference. The Court also has not yet ruled on the Company's transfer motion.

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

Frequency Systems LLC v NETGEAR, Inc.

On May 8, 2015, the Company was sued by a non-practicing entity named Frequency Systems LLC ("Frequency Systems") in the United States District Court, Eastern District of Texas. Frequency Systems alleges direct or indirect infringement by the Company of a single patent, U.S. Pat. No. 8,417,205 (the "205 Patent"), entitled "Antenna selection scheme for multiple antennae."

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Frequency Systems alleges infringement generically by the Company's "wireless routers and access points product families" without specifying any models.

Frequency Systems also simultaneously sued ADTRAN, TCL Communications, Amped Wireless, ASUS, Belkin, Buffalo, Cisco, D-Link, EnGenius Technologies, Extreme Networks, HP, HTC, Huawei, ATEN Technology, IOGear, Kyocera, LG, Linksys, Motorola Mobility, Novatel Wireless, Sharp, TP-Link, TRENDnet, Western Digital, ZTE, and ZyXEL.

The Company answered the complaint on July 23, 2015 asserting various defenses, including noninfringement and invalidity of the patent in suit.

Recently, it appears that Frequency Systems granted RPX Corporation a license. This is significant because the Company's products that use WiFi chipsets of licensed companies (i.e. companies that are RPX members) likely will be licensed. The licensed RPX members include Broadcom and Qualcomm-Atheros.

On September 24, 2015, Frequency Systems served preliminary infringement contentions. Frequency Systems alleges that the Company infringes claims 1, 2 and 4 of the '205 Patent by the sale of products that are compliant with the 802.11n wireless standard, and identifies the following Company models as exemplars: R8000, R7500, R7000, R6400, R6300, R6250, AC1450, R6220, R6200, R6100, R6050, WNDR4700, WNDR4720, WNDR4500, WNDR4300, WNDR3700, WNDR3400, WNR2500, JNR3210, WNR2020, R7900, R6700, D7800, D7000, D6400, D6200, DGND4000, DGND3700, C7000, C6300, C3700, MBR1515, MBR1515A, MVBR1517, MVBR1210C, WNDAP660, EX7000, EX6200, EX6150, EX6100, X3920, EX3700, WN2500RP, WN3000RP, EX2700, A6210, LG2200D, LG6100D, WNDAP620, WND930, WNDAP360, WNDAP350, WN203, WN802T, and D2200D.

The Court held its initial scheduling conference on September 30, 2015. The Company's invalidity contentions were submitted on November 25, 2015.

Frequency Systems granted RPX Corporation members a license sometime in the fall of 2015. This was significant because the Company's products that use WiFi chipsets of licensed companies (i.e. companies that are RPX members) became licensed to the '205 Patent, and essentially all of the Company's WiFi chip providers are licensed to the '205 patent through their RPX membership.

Accordingly, on November 23, 2015, Frequency Systems submitted an unopposed motion to dismiss its claims for relief against the Company without prejudice and with all attorneys' fees, costs of Court, and expenses borne by the party incurring same. On December 14, 2015, the Court ordered that Frequency Systems' claims for relief against the Company be dismissed without prejudice.

There was no material financial impact to the Company resulting from this litigation matter.

Verifire Network Solutions v NETGEAR, Inc.

On June 3, 2015, the Company was sued by a non-practicing entity named Verifire Network Solutions, LLC. ("Verifire") in the United States District Court, Eastern District of Texas. Verifire alleges direct infringement by the Company of a single patent, US Patent No. 8,463,727 (the "727 Patent"), entitled "Communication management system and communication management method," and the complaint targets Netgear's ProSAFE® business-class VPN Firewall and ProSECURE® UTM Firewall product families. Verifire recently has sued several other companies in the same Court on the same patent, including Fortinet, WatchGuard, Check Point, and Hewlett Packard.

The Company received an extension to answer the complaint and filed its Answer to the on August 26, 2015. On September 22, 2015, Verifire produced its preliminary infringement contentions. Verifire asserted that claims 1 and 3 of the '727 Patent cover all network security equipment, including firewalls such as the ProSAFE and ProSECURE lines manufactured by the Company.

Recently, many defendants settled, as RPX Corporation appears to have signed a settlement agreement with Verifire to settle out RPX members. The remaining defendants are: ADTRAN, Panda Distribution, Inc., and the Company. The Court held its initial scheduling conference on September 30, 2015. The Company's invalidity contentions were submitted on November 25, 2015. The Company served its initial disclosures on October 21, 2015, and the Company's invalidity contentions were served on November 25, 2015.

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, on January 7, 2016, the Company and Verifire settled the lawsuit for a one-time payment from the Company to Verifire in return for a perpetual, worldwide, and fully-paid-up license from Verifire to the Company to all of Verifire's currently-held patents. The Court dismissed the case with prejudice on January 26, 2016. The settlement did not have a material financial impact to the Company.

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 Chrimar 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 received an extension until September 15, 2015 to answer the complaint. The Company answered the complaint with a Motion to Dismiss Chrimar's indirect infringement claims. Chrimar subsequently filed a response to the Company's motion to dismiss and Chrimar's First Amended Complaint. Chrimar responded to the Motion to Dismiss by dropping its induced infringement claims and providing supplemental allegations in support of its contributory infringement claims with respect to the '760 Patent. For the '012, '107 and '838 Patents, Chrimar now only alleges direct infringement. Chrimar originally asserted direct and indirect infringement for all four patents-in-suit.

Subsequently, on October 5, 2015, the Company filed a Motion to Dismiss the Direct Infringement Claims Relating to the '760 Patent. Chrimar filed its response to this motion to dismiss on October 15, 2015, and the Company filed its Reply on October 26, 2015. Chrimar filed an Amended Complaint on December 23, 2015 to address the deficiencies in Chrimar's complaint pointed out by the Company's Motion to Dismiss the Direct Infringement Claims Relating to the '760 Patent, and the Company filed its Answer to the Amended Complaint on January 10, 2016.

On November 24, 2015, Chrimar served its infringement contentions on the Company, and Chrimar 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 NETGEAR'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, Chrimar 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.

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

Wi3, INC. v. NETGEAR, Inc.

On November 12, 2015, a lawsuit was filed against the Company by a company called Wi3, INC. (“Wi3”) in the United States District Court, Western District of New York. The patent No. 6,108,331 (the “331 Patent”) is entitled “Single Medium Wiring Scheme for Multiple Signal Distribution in Building and Access Port Therefor,” and was filed in 1998, and should expire in July 2018. The complaint alleges direct and indirect infringement, and accuses NETGEAR’s MoCA Network Adapters and/or Network Extenders (including at least model MCA1001 v2) of infringing at least claims 26, 27, 29, and 30. The complaint alleges no pre-suit knowledge of the patent, but seeks enhanced damages. The patent has been asserted in three prior cases, and all three cases were resolved in the early stages. The Company has received an extension until March 11, 2016 to answer the Complaint.

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

87

---

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

IP Indemnification Claims

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers (the “Indemnified Parties”) for any expenses or liability resulting from claimed infringements 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.

Environmental Regulation

The European Union (“EU”) enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods, including home and commercial business networking products, financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for the individual member states of the EU to transpose the directive into law in their respective countries was August 13, 2004 (such legislation, together with the directive, the “WEEE Legislation”). Producers participating in the market were financially responsible for implementing these responsibilities under the WEEE Legislation beginning in August 13, 2005. The Company adopted the authoritative guidance for asset retirement and environmental obligations in the third quarter of fiscal 2005 and has determined that its effect did not have a material impact on the Company's consolidated results of operations and financial position. The WEEE Directive was recast on July 24, 2012, published on August 13, 2012, and was implemented by all member states on February 14, 2014. The Company has determined that its effect did not have material impact on its consolidated results of operations and financial positions due to this recasting. Similar WEEE Legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China, India, Australia and Japan. The Company continues to monitor WEEE Legislation and similar legislation in other jurisdictions as individual countries issue their implementation guidance. The Company believes it has met the applicable requirements of current WEEE Legislation and similar legislation in other jurisdictions, to the extent implementation requirements has been published.

Additionally, the EU enacted the Restriction of Hazardous Substances Directive (“RoHS Legislation”), the REACH Regulation, Packaging Directive and the Battery Directive. EU RoHS Legislation, along with similar legislation in China, requires manufacturers to ensure certain substances, including polybrominated biphenyls (“PBD”), polybrominated diphenyl ethers (“PBDE”), mercury, cadmium, hexavalent chromium and lead (except for allowed exempted materials and applications), are below specified maximum concentration values in certain products put on the market after July 1, 2006. The RoHS Directive was recast on July 21, 2011 and went into force on January 3, 2013. The Company has determined that its effect did not have material impact on its consolidated results of operations and financial positions due to this recasting. The REACH Regulation requires manufacturers to ensure the published lists of substances of very high concern in certain products are below specified maximum concentration values. The Battery Directive controls use of certain types of battery technology in certain products and requires mandatory marking. The Company believes it has met the requirements of the RoHS Directive Legislation, the REACH Regulation and the Battery Directive Legislation.

Additionally, the EU enacted the Energy Using Product (“EuP”) Directive, which came into force in August 2007. The EuP Directive required manufacturers of certain products to meet minimum energy efficiency performance requirements. These requirements were documented in EuP implementing measures issued for specific product categories. The implementing measures affecting the Company's products are minimum power supply efficiencies and may include required equipment standby modes, which also reduce energy consumption. The EuP Directive was

repealed in November 2009 and replaced by the Energy Related Products ("ErP") Directive, which includes the same implementing measures of the former EuP Directive and new implementing measures applicable to the Company's products. The Company is in compliance with applicable implementing measures of the ErP Directives since it came into force.



Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Note 10. Stockholders' Equity

## Common Stock Repurchase Programs

On October 21, 2008, October 17, 2014 and July 21, 2015, the Company's Board of Directors authorized management to repurchase up to 6.0 million, 3.0 million and 3.0 million shares of the Company's outstanding common stock, respectively, which, at the time of authorization, were incremental to the remaining shares under the share repurchase programs. Under the authorizations, the Company may repurchase shares of its common stock, depending on market conditions, in the open market or through privately negotiated transactions. 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 December 31, 2015, both share repurchase programs authorized prior to July 2015 have been completed and there were 2.2 million shares remaining in the Company's buyback program. The Company repurchased, reported based on trade date, approximately 3.8 million shares of common stock at a cost of \$117.7 million during the year ended December 31, 2015. During the years ended December 31, 2014 and December 31, 2013, the Company repurchased and retired, reported based on trade date, approximately 2.8 million shares of common stock at a cost of \$90.6 million and approximately 2.0 million shares of common stock at a cost of \$63.1 million, respectively.

The Company repurchased, as reported based on trade date, approximately 85,000 shares of common stock at a cost of \$2.6 million, under a repurchase program to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the year ended December 31, 2015. Similarly, during the years ended December 31, 2014 and December 31, 2013, the Company repurchased approximately 82,000 shares of common stock at a cost of \$2.6 million and 14,000 shares of common stock at a cost of \$0.5 million, respectively, under the same program to help facilitate tax withholding for RSUs.

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

## Accumulated Other Comprehensive Income (Loss)

The following table sets forth the changes in accumulated other comprehensive income by component, net of tax, during the years ended December 31, 2015, 2014 and 2013 (in thousands):

|   | Gains and losses<br>on available for<br>sale securities | Gains and losses<br>on derivatives | Total |
|---|---|------------------------------------|-------|
| Balance as of December 31, 2012                                   | \$28  | \$(24)                             | \$4   |
| Other comprehensive income (loss) before reclassifications        | (24)  | 775                                | 751   |
| Amounts reclassified from accumulated other<br>comprehensive loss | —   | (686)                              | (686) |
| Net current period other comprehensive income (loss)              | (24)  | 89                                 | 65    |
| Balance as of December 31, 2013                                   | \$4   | \$65                               | \$69  |
| Other comprehensive income (loss) before reclassifications        | (9)   | 292                                | 283   |
| Amounts reclassified from accumulated other<br>comprehensive loss | —   | (314)                              | (314) |
| Net current period other comprehensive loss                       | (9)   | (22)                               | (31)  |

Edgar Filing: NETGEAR, INC - Form 10-K

|  |        |   |       |        |
|--|--------|---|-------|--------|
| Balance as of December 31, 2014                                | \$ (5  | ) | \$ 43 | \$ 38  |
| Other comprehensive income before reclassifications            | (35    | ) | 453   | 418    |
| Amounts reclassified from accumulated other comprehensive loss | —      |   | (453  | ) (453 |
| Net current period other comprehensive income                  | (35    | ) | —     | (35    |
| Balance as of December 31, 2015                                | \$ (40 | ) | \$ 43 | \$ 3   |

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables provide details about significant amounts reclassified out of each component of accumulated other comprehensive income for the years ended December 31, 2015, 2014 and 2013 (in thousands):

| Details about Accumulated Other Comprehensive Income Components | Year Ended December 31, 2015  |   | Year Ended December 31, 2014  |   | Year Ended December 31, 2013  |   |
|---|-------------------------------|---|-------------------------------|---|-------------------------------|---|
|   | Amount Reclassified from AOCI | Affected Line Item in the Statement of Operations | Amount Reclassified from AOCI | Affected Line Item in the Statement of Operations | Amount Reclassified from AOCI | Affected Line Item in the Statement of Operations |
| Gains and losses on cash flow hedge:                            |                               |   |                               |   |                               |   |
| Foreign currency forward contracts                              | \$462                         | Net revenue                                       | \$459                         | Net revenue                                       | \$844                         | Net revenue                                       |
| Foreign currency forward contracts                              | 6                             | Cost of revenue                                   | 4                             | Cost of revenue                                   | (9)                           | ) Cost of revenue                                 |
| Foreign currency forward contracts                              | (15)                          | ) Operating expenses                              | (149)                         | ) Operating expenses                              | (149)                         | ) Operating expenses                              |
|   | 453                           | Total before tax                                  | 314                           | Total before tax                                  | 686                           | Total before tax                                  |
|   | —                             | Tax expense (1)                                   | —                             | Tax expense (1)                                   | —                             | ) Tax expense (1)                                 |
|   | \$453                         | Total, net of tax                                 | \$314                         | Total, net of tax                                 | \$686                         | Total, net of tax                                 |

(1) Under our tax structure all hedging gains and losses from derivative contracts are ultimately borne by a legal entity in a jurisdiction with no income tax.

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 11. Employee Benefit Plans

2000 Stock Option Plan

In April 2000, the Company adopted the 2000 Stock Option Plan (the "2000 Plan"). The 2000 Plan provided for the granting of stock options to employees and consultants of the Company. Upon the Company's initial public offering in 2003, the 2000 Plan was terminated and all shares that remained reserved but not issued under the 2000 Plan at the time of its termination were transferred to the 2003 Plan. No further equity awards can be granted under the 2000 Plan. Outstanding awards under the 2000 Stock Plan remain subject to the terms and conditions of the 2000 Plan.

2003 Stock Plan

In April 2003, the Company adopted the 2003 Stock Plan (the "2003 Plan"). The 2003 Plan provided for the granting of stock options to employees and consultants of the Company. During the second quarter of 2013, the Company's 2003 Stock Plan expired. No further equity awards can be granted under the 2003 Plan. Outstanding awards under the 2003 Stock Plan remain subject to the terms and conditions of the 2003 plan.

2006 Long Term Incentive Plan

In April 2006, the Company adopted the 2006 Long Term Incentive Plan (the "2006 Plan"). The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, performance awards and other stock awards, to eligible directors, employees and consultants of the Company. Upon adoption of the 2006 Plan, the Company reserved 2,500,000 shares of common stock for issuance. During the period from 2008 to 2014, the Company adopted amendments which increased the number of shares of the Company's common stock that may be issued under the 2006 Plan by an additional 8.5 million shares. In addition, RSUs granted under the 2006 Plan on or after June 6, 2012 are counted against shares authorized under the plan as 1.58 shares of common stock for each share subject to such award. As of December 31, 2015, approximately 1.5 million shares were reserved for future grants under the 2006 Plan.

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

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

Restricted stock awards may be granted under the 2006 Plan subject to the terms specified by the plan administrator. The period over which any restricted award may fully vest is generally no less than three years. Restricted stock awards are non-vested stock awards that may include grants of restricted stock or grants of restricted stock units ("RSUs"). Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. During that period, ownership of the shares cannot be

transferred. Restricted stock has the same voting rights as other common stock and is considered to be currently issued and outstanding. RSUs do not have the voting rights of common stock, and the shares underlying the RSUs are not considered issued and outstanding. The Company expenses the cost of the restricted stock awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse.

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

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

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

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

## Employee Stock Purchase Plan

The Company sponsors an Employee Stock Purchase Plan (the "ESPP"), pursuant to which eligible employees may contribute up to 10% of compensation, subject to certain income limits, to purchase shares of the Company's common stock. Employees may purchase stock semi-annually at a price equal to 85% of the fair market value on the purchase date. Since the price of the shares is determined at the purchase date, the Company recognizes expense based on the 15% discount at purchase. For the years ended December 31, 2015, 2014, and 2013, the Company recognized ESPP compensation expense of \$0.5 million, \$0.5 million and \$0.4 million, respectively. As of December 31, 2015, 0.1 million shares were reserved for future issuance under the ESPP.

## Option Activity

Stock option activity during the year ended December 31, 2015 was as follows:

|                                  | Number of<br>Shares | Weighted<br>Average<br>Exercise Price<br>Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|---------------------|---|---|---------------------------------|
|                                  | (In thousands)      | (In dollars)  | (In years)  | (In thousands)                  |
| Outstanding at December 31, 2014 | 3,939               | \$30.58   |   |                                 |
| Granted                          | 296                 | 31.34   |   |                                 |
| Exercised                        | (1,353)             | ) 30.55   |   |                                 |
| Cancelled                        | (163)               | ) 33.09   |   |                                 |
| Expired                          | (258)               | ) 34.78   |   |                                 |
| Outstanding at December 31, 2015 | 2,461               | \$30.08   | 5.7   | \$29,109                        |
| As of December 31, 2015:         |                     |   |   |                                 |
| Vested and expected to vest      | 2,386               | \$30.02   | 5.6   | \$28,358                        |
| Exercisable Options              | 1,784               | \$29.26   | 4.7   | \$22,562                        |

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic values (the difference between the Company's closing stock price on the last trading day of 2015 and the exercise price, multiplied by the number of

shares underlying the in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2015. This amount changes based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the year ended December 31, 2015, 2014, and 2013 was \$11.4 million, \$3.4 million and \$4.2 million, respectively.

The total fair value of options vested during the years ended December 31, 2015, 2014, and 2013 was \$6.5 million, \$10.0 million and \$13.0 million, respectively.

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes significant ranges of outstanding and exercisable stock options as of December 31, 2015:

| Range of Exercise Prices | Options Outstanding                  |   |   | Options Exercisable                  |   |
|--------------------------|--------------------------------------|---|---|--------------------------------------|---|
|                          | Shares Outstanding<br>(In thousands) | Weighted-Average Remaining Contractual Life<br>(In years) | Weighted-Average Exercise Price Per Share<br>(In dollars) | Shares Exercisable<br>(In thousands) | Weighted-Average Exercise Price Per Share<br>(In dollars) |
| \$10.69 - \$28.79        | 591                                  | 3.01  | \$20.84   | 585                                  | \$20.77   |
| \$29.23 - \$31.31        | 573                                  | 6.65  | 30.86   | 274                                  | 30.39   |
| \$31.45 - \$32.54        | 557                                  | 7.53  | 32.49   | 291                                  | 32.48   |
| \$32.55 - \$35.32        | 583                                  | 5.70  | 34.24   | 504                                  | 34.32   |
| \$36.80 - \$40.01        | 157                                  | 5.25  | 38.13   | 130                                  | 38.36   |
| \$10.69 - \$40.01        | 2,461                                | 5.66  | \$30.08   | 1,784                                | \$29.26   |

## RSU Activity

RSU activity during the year ended December 31, 2015 was as follows:

|                                  | Number of Shares<br>(In thousands) | Weighted Average Grant Date Fair Value Per Share<br>(In dollars) | Weighted Average Remaining Contractual Term<br>(In years) | Aggregate Intrinsic Value<br>(In thousands) |
|----------------------------------|------------------------------------|--|---|---|
| Outstanding at December 31, 2014 | 858                                | \$30.68  |   |   |
| RSUs granted                     | 525                                | 32.16  |   |   |
| RSUs vested                      | (285)                              | 31.06  |   |   |
| RSUs cancelled                   | (134)                              | 31.52  |   |   |
| Outstanding at December 31, 2015 | 964                                | \$31.63  | 1.46  | \$40,399                                    |

Total intrinsic value of RSUs, or the release date fair value of RSUs, vested during the years ended December 31, 2015, 2014 and 2013 was \$8.9 million, \$9.0 million and \$2.9 million, respectively. The total fair value or RSUs, or the grant date fair value of RSUs, vested during the years ended December 31, 2015, 2014 and 2013 was \$8.8 million, \$8.4 million and \$2.3 million, respectively.

## 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 Employee Stock Purchase Plan ("ESPP") is based on the 15% discount at purchase, since the price of the shares is determined at the purchase date. The fair value of each option award 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 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 is based on historical volatility over the most recent period commensurate with the estimated expected term.

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table sets forth the weighted-average assumptions used to estimate the fair value stock option grants during the years ended December 31, 2015, 2014 and 2013:

|                          | Year Ended December 31, |   |      |   |       |   |
|--------------------------|-------------------------|---|------|---|-------|---|
|                          | 2015                    |   | 2014 |   | 2013  |   |
| Expected life (in years) | 4.5                     |   | 4.5  |   | 4.4   |   |
| Risk-free interest rate  | 1.44                    | % | 1.43 | % | 0.72  | % |
| Expected volatility      | 39.3                    | % | 42.6 | % | 48.05 | % |
| Dividend yield           | —                       |   | —    |   | —     |   |

The weighted average estimated fair value of options granted during the years ended December 31, 2015, 2014 and 2013 was \$10.83, \$12.04 and \$13.29, respectively.

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

|                            | Year Ended December 31, |          |          |
|----------------------------|-------------------------|----------|----------|
|                            | 2015                    | 2014     | 2013     |
| Cost of revenue            | \$1,566                 | \$2,037  | \$1,577  |
| Research and development   | 3,451                   | 4,916    | 3,943    |
| Sales and marketing        | 5,022                   | 6,168    | 5,379    |
| General and administrative | 6,786                   | 6,893    | 6,563    |
| Total                      | \$16,825                | \$20,014 | \$17,462 |

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

Total stock-based compensation cost capitalized in inventory was less than \$0.5 million in the year ended December 31, 2015, 2014 and 2013.

As of December 31, 2015, \$6.4 million of unrecognized compensation cost related to stock options, adjusted for estimated forfeitures, is expected to be recognized over a weighted-average period of 2.4 years. As of December 31, 2015, \$19.6 million of unrecognized compensation cost related to unvested RSUs, adjusted for estimated forfeitures, is expected to be recognized over a weighted-average period of 2.5 years.

## 401(k) Plan

In April 2000, the Company adopted the NETGEAR 401(k) Plan to which employees may contribute up to 100% of salary subject to the legal maximum. In the first quarter of 2012, the Company began matching 50% of contributions for employees that remain active with the Company through the end of the fiscal year, up to a maximum of \$6,000 in employee contributions. During the years ended December 31, 2015, 2014 and 2013 the Company recognized \$0.9 million, \$1.0 million and \$1.0 million, respectively, in expenses related to the 401(k) match.

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

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the Chief Operating Decision Maker (“CODM”) of an organization, in order to determine operating and resource allocation decisions. By this definition, the Company has identified its CEO as the CODM and operates in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home networking, home video security, storage and digital media products. The commercial business unit consists of business networking, storage and security solutions that bring enterprise class functionality down to the small and medium-sized business at an affordable price. The service provider business unit consists of made-to-order and retail proven, whole home networking hardware and software solutions as well as 4G LTE hotspots sold to service providers for sale to their

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

subscribers. Each business unit contains leadership focused on the product development efforts, both from a product marketing and engineering standpoint, to service the unique needs of these customer segments. The Company believes this structure enables it to better focus its efforts on the Company's core customer segments and allows it to be more nimble and opportunistic as a company overall.

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

|  | Year Ended December 31, |             |             |   |
|--|-------------------------|-------------|-------------|---|
|  | 2015                    | 2014        | 2013        |   |
| Net revenue:   |                         |             |             |   |
| Retail   | \$614,367               | \$508,100   | \$509,924   |   |
| Commercial   | 264,846                 | 305,677     | 311,261     |   |
| Service provider   | 421,482                 | 579,738     | 548,448     |   |
| Total net revenues   | \$1,300,695             | \$1,393,515 | \$1,369,633 |   |
| Contribution income:   |                         |             |             |   |
| Retail   | \$85,231                | \$76,266    | \$73,418    |   |
| Retail contribution margin   | 13.9                    | % 15.0      | % 14.4      | % |
| Commercial   | 53,393                  | 70,810      | 66,506      |   |
| Commercial contribution margin   | 20.2                    | % 23.2      | % 21.4      | % |
| Service Provider   | 39,151                  | 47,547      | 51,620      |   |
| Service Provider contribution margin   | 9.3                     | % 8.2       | % 9.4       | % |
| Total segment contribution income  | 177,775                 | 194,623     | 191,544     |   |
| Corporate and unallocated costs  | (54,501                 | ) (53,581   | ) (51,629   | ) |
| Amortization of intangibles (1)  | (16,969                 | ) (17,573   | ) (15,217   | ) |
| Stock-based compensation expense   | (16,825                 | ) (20,014   | ) (17,462   | ) |
| Restructuring and other charges  | (6,398                  | ) (2,209    | ) (5,335    | ) |
| Acquisition-related expense (2)  | —                       | (8          | ) (940      | ) |
| Impact to cost of sales from acquisition accounting adjustments to inventory | (407                    | ) —         | (568        | ) |
| Litigation reserves, net   | 2,682                   | 1,011       | (5,354      | ) |
| Goodwill impairment charges  | —                       | (74,196     | ) —         | ) |
| Intangibles impairment charges   | —                       | —           | (2,000      | ) |
| Interest income  | 295                     | 253         | 400         |   |
| Other income (expense), net  | (88                     | ) 2,455     | (457        | ) |

Edgar Filing: NETGEAR, INC - Form 10-K

|                            |          |          |          |
|----------------------------|----------|----------|----------|
| Income before income taxes | \$85,564 | \$30,761 | \$92,982 |
|----------------------------|----------|----------|----------|

---

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

(2) These acquisition-related charges were expensed in the period incurred and reported in the Company's consolidated statements of operations within cost of revenues and operating expense.

95

---

Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company conducts business across three geographic regions: Americas; Europe, Middle-East and Africa (“EMEA”) and Asia Pacific (“APAC”). Net revenue by geography comprises gross revenue less such items as end-user customer rebates and other sales incentives deemed to be a reduction of net revenue per the authoritative guidance for revenue recognition, sales returns and price protection. For reporting purposes revenue is attributed to each geographic region based on the location of the customer.

The following table shows net revenue by geography for the periods indicated (in thousands):

|                           | Year Ended December 31, |             |             |
|---------------------------|-------------------------|-------------|-------------|
|                           | 2015                    | 2014        | 2013        |
| United States (U.S.)      | \$779,361               | \$750,933   | \$769,357   |
| Americas (excluding U.S.) | 18,385                  | 19,957      | 19,961      |
| United Kingdom (U.K.)     | 103,649                 | 154,503     | 142,729     |
| EMEA (excluding U.K.)     | 218,065                 | 267,384     | 269,959     |
| APAC                      | 181,235                 | 200,738     | 167,627     |
| Total net revenue         | \$1,300,695             | \$1,393,515 | \$1,369,633 |

Best Buy Co., Inc. and Affiliates accounted for 15% of net revenue, wholly within the retail business unit, in the year ended December 31, 2015. No customers accounted for 10% or more of net revenue in the years ended December 31, 2014 and 2013.

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

|                        | As of             |                   |
|------------------------|-------------------|-------------------|
|                        | December 31, 2015 | December 31, 2014 |
| United States          | \$9,832           | \$12,453          |
| Canada                 | 3,586             | 4,375             |
| EMEA                   | 468               | 657               |
| China                  | 6,562             | 10,786            |
| APAC (excluding China) | 1,936             | 1,423             |
|                        | \$22,384          | \$29,694          |

## Note 13. Fair Value Measurements (in thousands)

The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

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

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

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

Table of Contents

NETGEAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of December 31, 2015 and 2014:

|   | As of December 31, 2015 |  |   |   |
|---|-------------------------|--|---|---|
|   | Total                   | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Cash equivalents-money-market funds                       | \$ 10,976               | \$ 10,976  | \$—   | \$—                                       |
| Available-for-sale securities- U.S. treasuries (1)        | 94,993                  | 94,993   | —   | —   |
| Available-for-sale securities-certificates of deposit (1) | 147                     | 147  | —   | —   |
| Trading securities - mutual funds (1)                     | 1,181                   | 1,181  | —   | —   |
| Foreign currency forward contracts (2)                    | 3,205                   | —  | 3,205   | —   |
| Total assets measured at fair value                       | \$ 110,502              | \$ 107,297                                       | \$ 3,205                                      | \$—                                       |

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

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

|  | As of December 31, 2015 |  |   |   |
|--|-------------------------|--|---|---|
|  | Total                   | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Foreign currency forward contracts (3)   | \$451                   | \$—  | \$451   | \$—                                       |
| Total liabilities measured at fair value | \$451                   | \$—  | \$451   | \$—                                       |

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

|   | As of December 31, 2014 |  |   |   |
|---|-------------------------|--|---|---|
|   | Total                   | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Cash equivalents-money-market funds                       | \$4,408                 | \$ 4,408   | \$—   | \$—                                       |
| Available-for-sale securities-U.S. treasuries (1)         | 114,935                 | 114,935  | —   | —   |
| Available-for-sale securities-certificates of deposit (1) | 158                     | 158  | —   | —   |
| Trading securities-mutual funds (1)                       | 802                     | 802  | —   | —   |
| Foreign currency forward contracts (2)                    | 2,416                   | —  | 2,416   | —   |
| Total assets measured at fair value                       | \$ 122,719              | \$ 120,303                                       | \$ 2,416                                      | \$—                                       |

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

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





Table of Contents

NETGEAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

|  | As of December 31, 2014 |  |   |   |
|--|-------------------------|--|---|---|
|  | Total                   | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Foreign currency forward contracts (3)   | \$447                   | \$—  | \$447   | \$—                                       |
| Total liabilities measured at fair value | \$447                   | \$—  | \$447   | \$—                                       |

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

The Company's investments in cash equivalents and available-for-sale securities are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company enters into foreign currency forward contracts with only those counterparties that have long-term credit ratings of A-/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. At December 31, 2015 and December 31, 2014, 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. Subsequent Event

In January 2016, the Company went through a restructuring to reduce the cost structure of the service provider business unit and supporting functions, to match the reduced revenue outlook and concentrate resources on long-term and profitable accounts. The Company estimates its cost will be between approximately \$1.5 million and \$2.5 million. These charges primarily include severance, other one-time termination benefits and other associated costs. The Company expects to record the majority of these charges and complete the restructuring by the end of the first fiscal quarter of 2016.

Table of Contents

## QUARTERLY FINANCIAL DATA

(In thousands, except per share amounts)  
(Unaudited)

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

|                              | December 31,<br>2015 | September 27,<br>2015 | June 28,<br>2015 | March 29,<br>2015 |
|------------------------------|----------------------|-----------------------|------------------|-------------------|
| Net revenue                  | \$360,863            | \$341,893             | \$288,782        | \$309,157         |
| Gross profit                 | \$105,416            | \$96,327              | \$77,656         | \$88,280          |
| Provision for income taxes   | \$8,927              | \$10,780              | \$7,258          | \$10,015          |
| Net income                   | \$21,807             | \$15,099              | \$3,667          | \$8,011           |
| Net income per share—basic   | \$0.68               | \$0.47                | \$0.11           | \$0.23            |
| Net income per share—diluted | \$0.66               | \$0.47                | \$0.11           | \$0.23            |

  

|                                      | December 31,<br>2014 | September 28,<br>2014 | June 29,<br>2014 | March 30,<br>2014 |
|--------------------------------------|----------------------|-----------------------|------------------|-------------------|
| Net revenue                          | \$353,182            | \$353,338             | \$337,604        | \$349,391         |
| Gross profit                         | \$100,474            | \$102,333             | \$97,186         | \$97,925          |
| Provision (benefit) for income taxes | \$(5,609)            | \$8,847               | \$9,698          | \$9,037           |
| Net income (loss)                    | \$(40,353)           | \$20,025              | \$14,705         | \$14,411          |
| Net income (loss) per share—basic    | \$(1.16)             | \$0.56                | \$0.41           | \$0.39            |
| Net income (loss) per share—diluted  | \$(1.16)             | \$0.55                | \$0.40           | \$0.39            |

(a) Net loss includes a non-cash goodwill impairment charge of \$74.2 million relating to the service provider business unit.

Table of Contents

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

None.

Item 9A. Controls and Procedures

Management's Report on Internal Control Over Financial Reporting

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

Our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, our management used the criteria established in Internal Control—Integrated Framework (2013), issued by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessment using those criteria, our management concluded that our internal control over financial reporting was effective as of December 31, 2015. The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included in this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the fourth quarter of fiscal year 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Evaluation of Disclosure Controls and Procedures

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

Item 9B. Other Information

None.

PART III

Certain information required by Part III is incorporated herein by reference from our proxy statement related to our 2016 Annual Meeting of Stockholders, which we intend to file no later than 120 days after the end of the fiscal year covered by this Form 10-K.

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item concerning our directors, executive officers, standing committees and procedures by which stockholders may recommend nominees to our Board of Directors, is incorporated by reference to the sections of our Proxy Statement under the headings “Information Concerning the Nominees and Incumbent Nominees,” “Board and Committee Meetings,” “Audit Committee” and “Section 16(a) Beneficial Ownership Reporting Compliance,” and to the information contained in the section captioned “Executive Officers of the Registrant” included under Part I of this Annual Report on Form 10-K.

100

---

Table of Contents

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

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

Item 11. Executive Compensation

The information required by this Item is incorporated by reference to the sections of our Proxy Statement under the headings “Compensation Discussion and Analysis,” “Executive Compensation,” “Director Compensation,” “Fiscal Year 2015 Director Compensation,” “Compensation Committee Interlocks and Insider Participation,” and “Report of the Compensation Committee of the Board of Directors.”

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

The additional information required by this Item is incorporated by reference to the information contained in the section captioned “Equity Compensation Plan Information” in our Proxy Statement.

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

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

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

Item 14. Principal Accounting Fees and Services

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

Table of Contents

## PART IV

## Item 15. Exhibits, Financial Statement Schedule

(a) The following documents are filed as part of this report:

## (1) Financial Statements.

|  |           |
|--|-----------|
|  | Page      |
| Report of Independent Registered Public Accounting Firm  | <u>55</u> |
| Consolidated Balance Sheets as of December 31, 2015 and 2014   | <u>56</u> |
| Consolidated Statements of Operations for the three years ended December 31, 2015, 2014 and 2013           | <u>57</u> |
| Consolidated Statements of Comprehensive Income for the three years ended December 31, 2015, 2014 and 2013 | <u>58</u> |
| Consolidated Statements of Stockholders' Equity for the three years ended December 31, 2015, 2014 and 2013 | <u>59</u> |
| Consolidated Statements of Cash Flows for the three years ended December 31, 2015, 2014 and 2013           | <u>60</u> |
| Notes to Consolidated Financial Statements   | <u>61</u> |
| Quarterly Financial Data (unaudited)   | <u>99</u> |
| Management's Report on Internal Control Over Financial Reporting   | <u>37</u> |

## (2) Financial Statement Schedule.

The following financial statement schedule of NETGEAR, Inc. for the fiscal years ended December 31, 2015, 2014 and 2013 is filed as part of this Form 10-K and should be read in conjunction with the consolidated financial statements of NETGEAR, Inc.

## Schedule II—Valuation and Qualifying Accounts

(In thousands)

|   | Balance at<br>Beginning<br>of Year | Additions | Deductions | Balance<br>at End of<br>Year |
|---|------------------------------------|-----------|------------|------------------------------|
| Allowance for doubtful accounts:          |                                    |           |            |                              |
| Year ended December 31, 2015              | \$1,255                            | \$35      | \$(35)     | ) \$1,255                    |
| Year ended December 31, 2014              | 1,255                              | 189       | (189)      | ) 1,255                      |
| Year ended December 31, 2013              | 1,256                              | 277       | (278)      | ) 1,255                      |
| Allowance for sales returns and warranty: |                                    |           |            |                              |
| Year ended December 31, 2015              | 62,376                             | 105,987   | (95,754)   | ) 72,609                     |
| Year ended December 31, 2014              | 66,221                             | 97,546    | (101,391)  | ) 62,376                     |
| Year ended December 31, 2013              | 63,690                             | 104,810   | (102,279)  | ) 66,221                     |
| Allowance for price protection:           |                                    |           |            |                              |
| Year ended December 31, 2015              | 1,806                              | 7,467     | (7,148)    | ) 2,125                      |
| Year ended December 31, 2014              | 4,273                              | 7,534     | (10,001)   | ) 1,806                      |
| Year ended December 31, 2013              | 1,783                              | 8,352     | (5,862)    | ) 4,273                      |

(3) Exhibits.

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

102

---



Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 19th day of February 2016.

NETGEAR, INC.

By: /s/ PATRICK C.S. LO

Patrick C.S. Lo

Chairman of the Board and Chief Executive  
Officer

Table of Contents

## POWER OF ATTORNEY

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

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

| Signature  | Title  | Date              |
|--|--|-------------------|
| /S/ PATRICK C.S. LO<br>Patrick C.S. Lo             | Chairman of the Board and Chief Executive Officer<br>(Principal Executive Officer) | February 19, 2016 |
| /S/ CHRISTINE M. GORJANC<br>Christine M. Gorjanc   | Chief Financial Officer<br>(Principal Financial and Accounting Officer)            | February 19, 2016 |
| /S/ JOCELYN CARTER-MILLER<br>Jocelyn Carter-Miller | Director   | February 19, 2016 |
| /S/ RALPH E. FAISON<br>Ralph E. Faison             | Director   | February 19, 2016 |
| /S/ A. TIMOTHY GODWIN<br>A. Timothy Godwin         | Director   | February 19, 2016 |
| /S/ JEF GRAHAM<br>Jef Graham                       | Director   | February 19, 2016 |
| /S/ GREGORY J. ROSSMANN<br>Gregory J. Rossmann     | Director   | February 19, 2016 |
| /S/ BARBARA V. SCHERER<br>Barbara V. Scherer       | Director   | February 19, 2016 |
| /S/ JULIE A. SHIMER<br>Julie A. Shimer             | Director   | February 19, 2016 |
| /S/ GRADY K. SUMMERS<br>Grady K. Summers           | Director   | February 19, 2016 |
| /S/ THOMAS H. WAECHTER<br>Thomas H. Waechter       | Director   | February 19, 2016 |



Table of Contents

## INDEX TO EXHIBITS

| Exhibit Number | Exhibit Description   | Incorporated by Reference |           |            | Filed Herewith |
|----------------|---|---------------------------|-----------|------------|----------------|
|                |   | Form                      | Date      | Number     |                |
| 2.1            | Asset Purchase Agreement, dated as of January 28, 2013, by and among the registrant, NETGEAR Holdings Limited, NETGEAR International Limited, NETGEAR Canada Limited, NETGEAR Australia PTY, LTD, Sierra Wireless, Inc., Sierra Wireless, Inc., Sierra Wireless America, Inc. and Sierra Wireless (Australia) PTY LTD | 10-K                      | 2/26/2013 | 10.35      |                |
| 3.1            | Amended and Restated Certificate of Incorporation of the registrant   | S-1                       | 7/30/2003 | 3.3        |                |
| 3.2            | Amended and Restated Bylaws of the registrant   | S-1                       | 7/30/2003 | 3.5        |                |
| 4.1            | Form of registrant's common stock certificate   | S-1                       | 7/30/2003 | 4.1        |                |
| 10.1           | Form of Indemnification Agreement for directors and officers  | S-1                       | 7/30/2003 | 10.1       |                |
| 10.2#          | 2000 Stock Option Plan and forms of agreements thereunder   | S-1                       | 7/30/2003 | 10.2       |                |
| 10.3#          | 2003 Stock Plan and forms of agreements thereunder, as amended  | 10-K                      | 2/26/2013 | 10.3       |                |
| 10.4#          | 2003 Employee Stock Purchase Plan, as amended   | 10-K                      | 2/26/2013 | 10.4       |                |
| 10.5#          | Amended and Restated 2006 Long-Term Incentive Plan and forms of agreements thereunder   | S-8                       | 6/6/2014  | 4.3        |                |
| 10.6#          | NETGEAR, Inc. Deferred Compensation Plan  | 8-K                       | 4/5/2013  | 10.1       |                |
| 10.7#          | NETGEAR, Inc. Executive Bonus Plan, as amended and restated April 1, 2013   | DEF14A                    | 4/16/2013 | Appendix A |                |
| 10.8*          | Warehousing Agreement, dated July 5, 2001, between the registrant and APL Logistics Americas, Ltd.  | S-1                       | 7/30/2003 | 10.25      |                |
| 10.9*          | Distribution Operation Agreement, dated April 27, 2001, between the registrant and DSV Solutions B.V. (formerly Furness Logistics BV)   | S-1                       | 7/30/2003 | 10.26      |                |
| 10.10*         | Distribution Operation Agreement, dated December 1, 2001, between the registrant and Kerry Logistics (Hong Kong) Limited  | S-1                       | 7/30/2003 | 10.27      |                |
| 10.11          | Office Lease, dated as of September 25, 2007, by and between the registrant and BRE/Plumeria, LLC   | 8-K                       | 9/27/2007 | 10.1       |                |
| 10.11a         | First Amendment to Office Lease, dated as of April 23, 2008, by and between the registrant and BRE/Plumeria, LLC  | 10-Q                      | 5/9/2008  | 10.1       |                |
| 10.11b         | Second Amendment to Office Lease, dated June 25, 2015, by and between the registrant and KBSII/Plumeria, LLC  |                           |           |            | X              |
| 10.12#         | Offer Letter, dated December 3, 1999, between the registrant and Patrick C.S. Lo  | S-1                       | 7/30/2003 | 10.5       |                |
| 10.12a#        | Amendment to Offer Letter, dated December 23, 2008, between the registrant and Patrick C.S. Lo  | 10-K                      | 3/4/2009  | 10.51      |                |
| 10.13#         | Offer Letter, dated December 9, 1999, between the registrant and Mark G. Merrill  | S-1                       | 7/30/2003 | 10.8       |                |
| 10.13a#        | Amendment to Offer Letter, dated December 28, 2008, between the registrant and Mark G. Merrill  | 10-K                      | 3/4/2009  | 10.52      |                |
| 10.14#         | Employment Agreement, dated November 4, 2002, between the registrant and Michael F. Falcon  | S-1                       | 7/30/2003 | 10.1       |                |

Edgar Filing: NETGEAR, INC - Form 10-K

|         |  |      |            |       |   |
|---------|--|------|------------|-------|---|
| 10.14a# | Amendment to Employment Agreement, dated December 29, 2008, between the registrant and Michael F. Falcon   | 10-K | 3/4/2009   | 10.49 |   |
| 10.15#  | Employment Agreement, dated November 16, 2005, between the registrant and Christine M. Gorjanc   | 8-K  | 11/22/2005 | 10.32 |   |
| 10.15a# | Amendment to Employment Agreement, dated December 31, 2008, between the registrant and Christine M. Gorjanc  | 10-K | 3/4/2009   | 10.50 |   |
| 10.15b# | Amendment #2 to Employment Agreement, dated September 21, 2009, between the registrant and Christine M. Gorjanc  | 8-K  | 9/21/2009  | 10.1  |   |
| 10.16#  | Change of Control and Severance Agreement, dated October 5, 2009, between the registrant and Andrew W. Kim   | 10-Q | 5/6/2014   | 10.1  |   |
| 10.17#  | Employment Agreement, dated July 8, 2013, between the registrant and John P. McHugh  | 8-K  | 7/11/2013  | 10.1  |   |
| 10.18#  | Separation Agreement and Mutual Release, dated February 26, 2014, between the registrant and David S.G. Soares   | 8-K  | 2/26/2014  | 10.1  |   |
| 10.19#  | Separation Agreement and Mutual Release, dated February 10, 2015, between the registrant and Michael Clegg   | 8-K  | 2/10/2015  | 10.1  |   |
| 10.20#  | Amended and Restated Change of Control and Severance Agreement, dated September 18, 2014, between the registrant and Jeffrey M. Capone   | 10-K | 2/20/2015  | 10.22 |   |
| 10.21#  | Amendment to Employment Agreement, dated October 20, 2015, between the registrant and Michael A. Werdann   |      |            |       | X |
| 21.1    | List of subsidiaries and affiliates  | 10-K | 2/25/2014  | 21.1  |   |
| 23.1    | Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm   |      |            |       | X |
| 24.1    | Power of Attorney (included on signature page)   |      |            |       | X |
| 31.1    | Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |      |            |       | X |
| 31.2    | Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |      |            |       | X |
| 32.1    | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                              |      |            |       | X |
| 32.2    | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                              |      |            |       | X |
| 101.INS | XBRL Instance Document   |      |            |       | X |

Table of Contents

|         |  |   |
|---------|--|---|
| 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 |

- # Indicates management contract or compensatory plan or arrangement.
- \* Confidential treatment has been granted as to certain portions of this Exhibit.