NETGEAR, INC
Form 10-Q
August 08, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended June 29, 2008.

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

Commission file number: 000-50350

NETGEAR, Inc.

(Exact name of registrant as specified in its charter)

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

(408) 907-8000

(Registrant s telephone number including area code)

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

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

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

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

The number of outstanding shares of the registrant s Common Stock, $0.001 par value, was 35,423,686 as of August 1, 2008.

TABLE OF CONTENTS

	PART I: FINANCIAL INFORMATION	3
Item 1.	Financial Statements	3
	Unaudited Condensed Consolidated Balance Sheets	3
	Unaudited Condensed Consolidated Statements of Operations	4
	Unaudited Condensed Consolidated Statements of Cash Flows	5
	Notes to Unaudited Condensed Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	27
Item 4.	Controls and Procedures	27
	PART II: OTHER INFORMATION	28
Item 1.	Legal Proceedings	28
Item 1A.	Risk Factors	28
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	39
Item 3.	Defaults Upon Senior Securities	39
Item 4.	Submission of Matters to a Vote of Security Holders	39
Item 6.	Exhibits	40
Signatures		41

EXHIBIT 10.1

EXHIBIT 10.2

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	June 29, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 167,053	$ 167,495
Short-term investments	19,775	37,848
Accounts receivable, net	159,039	157,765
Inventories	106,387	83,023
Deferred income taxes	14,784	13,091
Prepaid expenses and other current assets	24,727	20,367
Total current assets	491,765	479,589
Property and equipment, net	19,573	11,205
Intangibles, net	13,953	16,319
Goodwill	41,985	41,985
Other non-current assets	2,053	2,011
Total assets	$ 569,329	$ 551,109
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 46,359	$ 55,333
Accrued employee compensation	12,205	16,085
Other accrued liabilities	87,510	89,470
Deferred revenue	4,339	7,619
Income taxes payable	96	
Total current liabilities	150,509	168,507
Deferred income tax liability	1,463	2,626
Non-current income taxes payable	11,195	8,272
Other non-current liabilities	5,264	181
Total liabilities	168,431	179,586
Commitments and contingencies (Note 10)		
Stockholders equity:		
Common stock	35	35
Additional paid-in capital	259,760	252,421
Cumulative other comprehensive income	30	101
Retained earnings	141,073	118,966
Total stockholders equity	400,898	371,523

Total liabilities and stockholders equity	$ 569,329	$ 551,109

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

Table of Contents

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net revenue	$ 204,464	$ 164,275	$ 402,618	$ 337,847
Cost of revenue (1)	138,055	108,321	272,346	221,863
Gross profit	66,409	55,954	130,272	115,984
Operating expenses:				
Research and development (1)	8,584	6,909	17,322	13,065
Sales and marketing (1)	31,192	28,421	64,220	56,247
General and administrative (1)	7,877	6,948	15,190	13,862
In-process research and development		4,100		4,100
Litigation reserves, net			51	
Total operating expenses	47,653	46,378	96,783	87,274
Income from operations	18,756	9,576	33,489	28,710
Interest income	1,040	2,193	2,552	4,564
Other income (expense), net	(14)	1,148	2,829	1,420
Income before income taxes	19,782	12,917	38,870	34,694
Provision for income taxes	8,718	6,784	16,580	14,540
Net income	$ 11,064	$ 6,133	$ 22,290	$ 20,154
Net income per share:				
Basic	$ 0.31	$ 0.18	$ 0.63	$ 0.58
Diluted	$ 0.31	$ 0.17	$ 0.62	$ 0.57
Weighted average shares outstanding used to compute net income per share:				
Basic	35,354	34,685	35,335	34,496
Diluted	35,792	35,827	35,881	35,609
(1) Stock-based compensation expense was allocated as follows:				
Cost of revenue	$ 219	$ 155	$ 441	$ 288
Research and development	863	529	1,664	998
Sales and marketing	881	916	1,728	1,538
General and administrative	978	744	1,906	1,367

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

NETGEAR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended	
	June 29, 2008	**July 1, 2007**
Cash flows from operating activities:		
Net income	$ 22,290	$ 20,154
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,476	7,479
Accretion of purchase discounts on investments	(11)	(727)
Non-cash stock-based compensation	5,739	4,191
Income tax benefit associated with stock option exercises	24	6,565
Excess tax benefit from stock-based compensation	(137)	(5,594)
Deferred income taxes	(2,858)	95
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(1,274)	(14,993)
Inventories	(23,364)	(4,178)
Prepaid expenses and other assets	(4,402)	(4,727)
Accounts payable	(8,974)	(6,340)
Accrued employee compensation	(3,880)	1,045
Other accrued liabilities	3,168	3,361
Deferred revenue	(3,280)	505
Income taxes payable	3,019	(1,360)
Net cash provided by (used in) operating activities	(8,464)	5,476
Cash flows from investing activities:		
Purchases of short-term investments	(10,133)	(60,144)
Proceeds from sale of short-term investments	28,100	63,300
Purchase of property and equipment	(11,475)	(3,981)
Payments made in connection with business acquisition, net of cash acquired		(57,442)
Net cash provided by (used in) investing activities	6,492	(58,267)
Cash flows from financing activities:		
Purchase and retirement of treasury stock	(183)	(38)
Proceeds from exercise of stock options	843	7,364
Proceeds from issuance of common stock under employee stock purchase plan	733	627
Excess tax benefit from stock-based compensation	137	5,594
Net cash provided by financing activities	1,530	13,547
Net decrease in cash and cash equivalents	(442)	(39,244)
Cash and cash equivalents, at beginning of period	167,495	87,736
Cash and cash equivalents, at end of period	$ 167,053	$ 48,492

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

NETGEAR, Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Summary of Significant Accounting Policies

NETGEAR, Inc. was incorporated in Delaware in January 1996. NETGEAR, Inc. together with its subsidiaries (collectively, NETGEAR or the Company) designs, develops and markets networking products that address the specific needs of small businesses and homes, enabling users to share Internet access, peripherals, files and digital content and applications among multiple networked devices. The Company s products include Ethernet networking products, broadband access products and wireless networking connectivity products that are sold worldwide through distributors, traditional retailers, online retailers, direct market resellers, or DMRs, value added resellers, or VARs, and broadband service providers.

The accompanying unaudited condensed consolidated financial statements include the accounts of NETGEAR, Inc., and its wholly owned subsidiaries. They have been prepared in accordance with established guidelines for interim financial reporting and with the instructions of Form 10-Q and Article 10 of Regulation S-X. All significant intercompany balances and transactions have been eliminated in consolidation. The balance sheet at December 31, 2007 has been derived from audited financial statements at such date. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments considered necessary (consisting only of normal recurring adjustments) to fairly state the Company s financial position, results of operations and cash flows for the periods indicated. These unaudited condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect 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 and operating results for the three and six months ended June 29, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The Company s significant accounting policies are disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2007. The Company s significant accounting policies have not materially changed during the six months ended June 29, 2008.

2. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other existing accounting pronouncements that require or permit fair value measurements, as the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. Effective January 1, 2008, the Company adopted SFAS 157 as it relates to financial assets and liabilities recognized at fair value on a recurring basis. Additional disclosures required by SFAS 157 are included in Note 11.

In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), which delays the effective date of SFAS 157 until January 1, 2009 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. These nonfinancial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. The Company is currently evaluating the impact of SFAS 157 for nonfinancial assets and liabilities on the consolidated financial statements.

Table of Contents

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115, (SFAS 159) which permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This election is irrevocable. SFAS 159 was effective in the first quarter of fiscal 2008. The Company has not elected to apply the fair value option to any of its financial instruments.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R) and SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51 (SFAS 160). SFAS 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 160 will change the accounting and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. SFAS 141R and SFAS 160 are effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact of adopting SFAS 141R and SFAS 160 on the consolidated financial statements.

In March 2008, the FASB issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities and how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS 161 on the consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, Determination of the Useful Life of Intangible Assets . FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets . This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company is currently evaluating the impact that FSP 142-3 will have on the consolidated financial statements.

3. Stock-based Compensation

The Company grants options and restricted stock units from the Amended and Restated 2006 Long-Term Incentive Plan, under which awards may be granted to all employees. In addition, the Company s stock option program includes the 2003 Stock Plan, from which the Company does not currently grant awards, but may choose to do so. Award vesting periods for these plans are generally four years. As of June 29, 2008, 2,542,970 shares were reserved for future grants under these plans.

Additionally, the Company sponsors an Employee Stock Purchase Plan (the ESPP), pursuant to which eligible employees may contribute up to 10% of base 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.

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option valuation model and the weighted average assumptions in the following table. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk free interest rate is based on the implied yield currently available on U.S. Treasury securities with an equivalent remaining term. Expected volatility is based on a combination of the historical volatility of the Company s stock as well as the historical volatility of certain of the Company s industry peers stock:

	Stock Options Three Months Ended		Stock Options Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Expected life (in years)	4.3	4.5	4.3	4.5
Risk-free interest rate	3.04%	4.58%	3.07%	4.61%
Expected volatility	50%	54%	49%	54%
Dividend yield				

Table of Contents

As of June 29, 2008, $26.3 million of total unrecognized compensation cost related to stock options, adjusted for estimated forfeitures, is expected to be recognized over a weighted-average period of 1.32 years. Additionally, $5.8 million of total unrecognized compensation cost related to non-vested restricted stock awards, adjusted for estimated forfeitures, is expected to be recognized over a weighted-average period of 1.24 years.

4. Product Warranties

The Company provides for estimated future warranty obligations at the time revenue is recognized. The Company s standard warranty obligation to its direct customers generally provides for a right of return of any product for a full refund in the event that such product is not merchantable or is found to be damaged or defective. At the time revenue is recognized, an estimate of future warranty returns is recorded to reduce revenue in the amount of the expected credit or refund to be provided to its direct customers. At the time the Company records the reduction to revenue related to warranty returns, the Company includes within cost of revenue a write-down to reduce the carrying value of such products to net realizable value. The Company s standard warranty obligation to its end-users provides for repair or 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 contract manufacturers, in certain cases the Company has recourse to the contract manufacturer for replacement or credit for the defective products. The Company gives consideration to amounts recoverable from its contract manufacturers in determining its warranty liability. The Company assesses the adequacy of its warranty liability every quarter and, as necessary, makes adjustments to the liability. Changes in the Company s warranty liability, which is included as a component of Other accrued liabilities in the condensed consolidated balance sheets, are as follows (in thousands):

	Six Months Ended	
	June 29, 2008	July 1, 2007
Balance as of beginning of the period	$ 27,557	$ 21,299
Provision for warranty liability made during the period	33,090	18,788
Warranty obligation assumed in acquisition		432
Settlements made during the period	(24,573)	(18,818)
Balance at end of period	$ 36,074	$ 21,701

5. 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. Shipping and handling costs associated with outbound freight are included in sales and marketing expenses and totaled $3.3 million for the three months ended June 29, 2008, $2.7 million for the three months ended July 1, 2007, $6.6 million for the six months ended June 29, 2008, and $5.8 million for the six months ended July 1, 2007.

6. Balance Sheet Components

Accounts receivable, net:

	June 29, 2008	December 31, 2007
	(In thousands)	
Gross accounts receivable	$ 173,740	$ 169,986
Less: Allowance for doubtful accounts	(2,036)	(2,307)
Allowance for sales returns	(8,548)	(9,417)
Allowance for price protection	(4,117)	(497)
Total allowances	(14,701)	(12,221)

Accounts receivable, net	$ 159,039	$ 157,765

Table of Contents

Inventories:

	June 29, 2008	December 31, 2007
	(In thousands)	
Raw materials	$ 616	$ 496
Finished goods	105,771	82,527
Total	$ 106,387	$ 83,023

Property and equipment, net:

	June 29, 2008	December 31, 2007
	(In thousands)	
Computer equipment	$ 5,822	$ 7,798
Furniture, fixtures and leasehold improvements	3,067	2,699
Software	9,318	10,237
Machinery	7,271	7,075
Construction in progress	12,780	3,305
	38,258	31,114
Less: accumulated depreciation and amortization	(18,685)	(19,909)
Property and equipment, net	$ 19,573	$ 11,205

The increase in property and equipment, net during the six months ended June 29 2008 compared to December 31, 2007 is primarily due to purchases of approximately $4.7 million related to our move to a new headquarters facility in San Jose, California and approximately $4.6 million related to our new enterprise resource planning software, offset by depreciation taken during the six months ended June 29, 2008.

Other accrued liabilities:

	June 29, 2008	December 31, 2007
	(In thousands)	
Sales and marketing programs	$ 30,828	$ 39,796
Warranty obligation	36,074	27,557
Freight	3,209	4,728
Other	17,399	17,389
Other accured liablities	$ 87,510	$ 89,470

7. Net Income Per Share

Basic net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. Potentially dilutive common shares include outstanding stock options and unvested restricted stock awards, which are reflected in diluted net income per share by application of the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of

stock-based compensation cost for future services that the Company has not yet recognized, and the amount of tax benefit that would be recorded in additional paid-in capital upon exercise are assumed to be used to repurchase shares.

Table of Contents

Net income per share for the three and six months ended June 29, 2008 and July 1, 2007 are as follows (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net income	$ 11,064	$ 6,133	$ 22,290	$ 20,154
Weighted average shares outstanding:				
Basic	35,354	34,685	35,335	34,496
Dilutive potential common shares	438	1,142	546	1,113
Total diluted	35,792	35,827	35,881	35,609
Basic net income per share	$ 0.31	$ 0.18	$ 0.63	$ 0.58
Diluted net income per share	$ 0.31	$ 0.17	$ 0.62	$ 0.57

Weighted average stock options and unvested restricted stock awards to purchase 3,104,757 and 2,822,180 shares of the Company s stock for the three and six months ended June 29, 2008, respectively, and 816,564 and 1,019,785 shares for the three and six months ended July 1, 2007, respectively, were excluded from the computation of diluted net income per share because their effect would have been anti-dilutive.

8. Income Taxes

The effective tax rate was 44.1% and 42.7% for the three and six months ended June 29, 2008, respectively. The effective tax rate was 52.5% and 41.9% for the three and six months ended July 1, 2007, respectively. The decrease in the effective tax rate for the three and six months ended June 29, 2008 compared to the same periods ended July 1, 2007 is primarily caused by non-deductible in-process research and development expense from the acquisition of Infrant Technologies, Inc. (Infrant) in the second quarter of 2007 that is non-recurring in 2008. The decrease in the tax rate from the non-recurring expense is partially offset by increases in the mix of forecasted profits in jurisdictions with relatively higher tax rates for fiscal 2008 as compared to fiscal 2007. Additionally, provisions in the U.S. federal tax law allowing taxpayers to claim credits related to research and development activities expired on December 31, 2007. Accordingly, no benefit has been recorded in the three months and six months ended June 29, 2008 for these credits.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48) on January 1, 2007. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. As of June 29, 2008, the liability for unrecognized tax benefits, net of federal impacts on state tax issues, is $11.2 million. No unrecognized tax benefit is expected to be paid within one year, nor can the Company make a reliable estimate when cash settlement with a taxing authority may occur.

For the three and six month periods ended June 29, 2008, the increase in gross unrecognized tax benefits was $1.4 million and $2.6 million, respectively. The increase in unrecognized tax benefits that, if recognized, would affect the effective tax rate was $1.3 million and $2.5 million, respectively. The increase in accrued interest expense for the same periods was $271,000 and $438,000, respectively.

The Company conducts business globally and, as a result, the Company and its subsidiaries or branches file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business the Company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States and Ireland. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2002.

During the three and six months ended June 29, 2008, there were no settlements or lapses of statutes of limitation.

9. Segment Information, Operations by Geographic Area and Significant Customers

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 of an organization, in order to determine operating and resource allocation decisions. By this definition, the Company operates in one business segment, which comprises the development, marketing

Table of Contents

and sale of networking products for the small business and home markets. The Company s headquarters and a significant portion of its operations are located in North America. The Company also conducts sales, marketing, customer service activities and certain distribution center activities through several small sales offices in Europe, Middle-East and Africa (EMEA) and Asia as well as outsourced distribution centers.

For reporting purposes revenue is attributed to each geographic region based on the location of the customer. Net revenue by geographic region comprises gross revenue less such items as end-user customer rebates and other sales incentives deemed to be a reduction of net revenue per Emerging Issues Task Force (EITF) Issue No. 01-9, sales returns and price protection.

Net revenue by geographic location is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
United States	$ 75,900	$ 61,787	$ 155,103	$ 127,846
United Kingdom	35,623	50,084	74,002	96,338
EMEA (excluding U.K.)	61,959	35,071	121,725	81,369
Asia Pacific and rest of the world	30,982	17,333	51,788	32,294
	$ 204,464	$ 164,275	$ 402,618	$ 337,847

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

	June 29, 2008	December 31, 2007
United States	$ 17,416	$ 9,459
EMEA	1,002	578
Asia Pacific and rest of the world	1,155	1,168
	$ 19,573	$ 11,205

Significant customers are as follows (as a percentage of net revenue):

	Three Months Ended		Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Ingram Micro, Inc.	13%	18%	14%	18%
Tech Data Corporation	11%	13%	11%	14%
All others individually less than 10% of net revenue	76%	69%	75%	68%
	100%	100%	100%	100%

10. Commitments and Contingencies

Litigation and Other Legal Matters

NETGEAR v. CSIRO

In May 2005, the Company filed a complaint for declaratory relief against the Commonwealth Scientific and Industrial Research Organization (CSIRO), in the San Jose division of the United States District Court, Northern District of California. The complaint alleges that the claims of CSIRO s U.S. Patent No. 5,487,069 are invalid and not infringed by any of the Company s products. CSIRO had asserted that the Company s wireless networking products implementing the IEEE 802.11a and 802.11g wireless LAN standards infringe its patent. In July 2006, the United States Court of Appeals for the Federal Circuit affirmed the District Court s decision to deny CSIRO s motion to dismiss the action under the Foreign Sovereign Immunities Act. In September 2006, the Federal Circuit

Table of Contents

denied CSIRO s request for a rehearing en banc. CSIRO filed a response to the complaint in September 2006. In December 2006, the District Court granted CSIRO s motion to transfer the case to the Eastern District of Texas, where CSIRO had brought and won a similar lawsuit against Buffalo Technology (USA), Inc., which Buffalo is currently appealing. This action is in the discovery phase. The Company attended a court-mandated mediation in November 2007 but failed to resolve the litigation. The District Court held a June 26, 2008 claim construction hearing but has not yet issued its ruling. The District Court has scheduled an April 13, 2009 jury trial.

Linex Technologies v. NETGEAR

In June 2007, a lawsuit was filed against the Company by Linex Technologies, Inc. (Linex), a patent holding company organized under the laws of Delaware, in the U.S. District Court, Eastern District of Texas. Linex alleges that the Company infringes U.S. Patent No. 6,757,322. Linex has accused certain of the Company s wireless networking products incorporating multiple input/multiple output (MIMO) technology of infringement. Linex has also sued 14 other technology companies alleging similar claims of patent infringement. The Company filed its answer in the third quarter of 2007. This action is in the discovery phase. The parties have scheduled a court-mandated mediation to take place on August 26, 2008. The District Court has scheduled a January 15, 2009 claim construction hearing.

Wi-Lan Inc. v. NETGEAR

In October 2007, a lawsuit was filed against the Company by Wi-Lan Inc. (Wi-Lan), a patent holding company existing under the laws of Canada, in the U.S. District Court, Eastern District of Texas. Wi-Lan alleges that the Company infringes U.S. Patent Nos. 5,282,222, RE37,802 and 5,956,323. Wi-Lan has accused the Company s wireless networking products compliant with the IEEE 802.11 standards and ADSL products compliant with the ITU G.992 standards of infringement. Wi-Lan has also sued 21 other technology companies alleging similar claims of patent infringement. The Company filed its answer in the first quarter of 2008. This action is now entering the discovery phase.

Fujitsu et. al v. NETGEAR

In December 2007, a lawsuit was filed against the Company by Fujitsu Limited, LG Electronics, Inc. and U.S. Philips Corporation in the U.S. District Court, Western District of Wisconsin. The plaintiffs allege that the Company infringes U.S. Patent Nos. 6,018,642, 6,469,993 and 4,975,952. The plaintiffs accuse the Company s wireless networking products compliant with the IEEE 802.11 standards of infringement. The Company filed its answer in the first quarter of 2008. This action is in the discovery phase. The District Court has scheduled an August 15, 2008 claim construction hearing and an April 27, 2009 jury trial.

OptimumPath, L.L.C. v. NETGEAR

In January 2008, a lawsuit was filed against the Company by OptimumPath, L.L.C (OptimumPath), a patent holding company existing under the laws of the State of South Carolina, in the U.S. District Court for the District of South Carolina. OptimumPath alleges that the Company infringes U.S. Patent No. 7,035,281. OptimumPath has accused the Company s wireless networking products of infringement. OptimumPath has also sued six other technology companies alleging similar claims of patent infringement. The Company filed its answer in the second quarter of 2008.

Network-1 Security Solutions, Inc. v. NETGEAR

In February 2008, a lawsuit was filed against the Company by Network-1 Security Solutions, Inc. (Network-1), a patent holding company existing under the laws of the State of Delaware, in the U.S. District Court for the Eastern District of Texas. Network-1 alleges that the Company infringes U.S. Patent No. 6,218,930. Network-1 has accused the Company s power over Ethernet products of infringement. Network-1 has also sued six other companies alleging similar claims of patent infringement. The Company filed its answer in the second quarter of 2008. The District Court has scheduled a December 3, 2009 claim construction hearing and a July 6, 2010 jury trial.

Fenner Investments Ltd. v. NETGEAR

In February 2008, a lawsuit was filed against the Company by Fenner Investments, Ltd. (Fenner), a patent holding company existing under the laws of the State of Texas, in the U.S. District Court for the Eastern District of Texas. Fenner alleges that the Company infringes U.S. Patent No. 7,145,906 entitled Packet Switching Node and U.S. Patent No. 5,842,224 entitled Method and

12

Table of Contents

Apparatus for Source Filtering Data Packets Between Networks of Differing Media . Fenner has also sued six other companies alleging similar claims of patent infringement. The Company filed its answer in the second quarter of 2008. The District Court has scheduled a February 19, 2009 claim construction hearing and an October 13, 2009 jury trial.

Ruckus Wireless v. NETGEAR

In May 2008, a lawsuit was filed against the Company by Ruckus Wireless (Ruckus), a developer of Wi-Fi technology, in the U.S. District Court for the Northern District of California. Ruckus alleges that the Company infringes U.S. Patent Nos. 7,358,912 and 7,193,562 in the course of deploying Wi-Fi antenna array technology in its products. The Company filed its answer in the third quarter of 2008.

Rates Technology Inc. v. NETGEAR

In June 2008, a lawsuit was filed against the Company by Rates Technology Inc. (Rates), a company existing under the laws of the State of Delaware, in the U.S. District Court for the Southern District of New York. Rates alleges that the Company infringes U.S. Patent Nos. 5,425,085 and 5,519,769 by selling products for use in or as a part of VoIP internet telephone systems. The Company is in the process of assessing the claims asserted by Rates.

EZ4Media, Inc. v. NETGEAR

In June 2008, a lawsuit was filed against the Company by EZ4Media, Inc. (EZ4Media) in the U.S. District Court for the Northern District of Illinois. EZ4Media alleges that the Company s digital media receivers infringe U.S. Patent Nos. 7,142,934, 7,142,935, 7,167,765 and 7,130,616. EZ4Media has also sued eight other companies alleging similar claims of patent infringement. The Company is in the process of assessing the claims asserted by EZ4Media.

IP Indemnification Claims

In addition, in its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers (the Indemnified Parties) for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties that are asserted against the Indemnified Parties. The terms of these indemnification agreements are generally perpetual any time 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.

In December 2005, the Company received a request for indemnification from Charter Communications, Inc. (Charter), a direct customer, related to a lawsuit filed in the U.S. District Court, Eastern District of Texas, by Hybrid Patents, Inc. (Hybrid), a patent holding company. Hybrid alleged that Charter infringed U.S. Patent Nos. 5,586,121, 5,818,845, 6,104,727 and Re. 35,774. Hybrid alleged that products implementing the Data Over Cable Service Interface Specification (DOCSIS) standard, which are supplied to Charter by, among others, the Company, infringed these patents. In the third quarter of 2006, the Company together with a number of other equipment suppliers to Charter assumed the defense of the litigation. In the second quarter of 2007, a jury found that the Hybrid patents were not infringed by Charter. Hybrid filed similar lawsuits in the same jurisdiction against Comcast Corporation, Comcast of Dallas, LP, Time Warner Cable, Inc. and Cox Communications, Inc., all of whom are also customers of the Company. In May 2008, the Company, together with several co-defendants, agreed to settle the litigation as part of a group settlement with Hybrid. Without admitting any patent infringement, wrongdoing or violation of law and to avoid the distraction and expense of continued litigation, the Company agreed to make a one-time payment of $450,000 for its portion of the settlement, in exchange for a fully paid perpetual license to all Hybrid patents, including those asserted in the lawsuit. Based on the historical and estimated projected future unit sales of the Company s products that were alleged to infringe the asserted patents, the Company allocated $109,000 of the settlement cost towards product shipments prior to the settlement, which the Company recorded as a litigation settlement expense in the three months ended March 30, 2008. Additionally, the Company allocated $341,000 of the settlement cost to prepaid royalties which is recognized as a component of cost of revenue as the related products are sold.

In June 2006, the Company received a request for indemnification from Charter and Charter Communications Operating, LLC, related to a lawsuit filed in the U.S. District Court, Eastern District of Texas, by Rembrandt Technologies, L.P. (Rembrandt), a patent holding company. Rembrandt alleges that Charter infringes U.S. Patent Nos. 5,243,627, 5,852,631, 5,719,858 and 4,937,819. Rembrandt alleges that products implementing the DOCSIS standard, which are supplied to Charter by, among others, the Company, infringe these patents. Rembrandt has also filed a similar lawsuit in the same jurisdiction against Comcast Corporation, Comcast Cable

Communications, LLC and Comcast of Plano, LP. In November 2007, the Company along with Motorola, Inc., Cisco Systems, Inc., Scientific-Atlanta, Inc., ARRIS Group, Inc., Thomson, Inc. and Ambit Microsystems, Inc. filed a complaint for declaratory judgment in the U.S. District Court for the District of Delaware against Rembrandt, seeking a declaration that Rembrandt s alleged patents are either invalid or not infringed. The action is currently in the discovery phase. The District Court held a claim construction hearing on August 5, 2008, and has scheduled a September 9, 2009 jury trial.

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

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

Environmental Regulation

The European Union (EU) has enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods, including home and small 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 enact the directive in their respective countries was August 13, 2004 (such legislation, together with the directive, the WEEE Legislation). Producers participating in the market are financially responsible for implementing these responsibilities under the WEEE Legislation beginning in August 2005. Similar WEEE Legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China and Japan. The Company adopted FSP SFAS No. 143-1, Accounting for Electronic Equipment Waste Obligations , in the third quarter of fiscal 2005 and has determined that its effect did not have a material impact on its consolidated results of operations and financial position for the three and six months ended June 29, 2008 and the three and six months ended July 1, 2007. The Company is continuing to evaluate the impact of the WEEE Legislation and similar legislation in other jurisdictions as individual countries issue their implementation guidance.

Additionally, the EU has enacted the Restriction of Hazardous Substances Directive (RoHS Legislation). The RoHS Legislation, along with similar legislation in China, prohibits the use of certain substances, including mercury and lead, in certain products put on the market after July 1, 2006. The Company believes it has met the requirements of the RoHS Legislation.

Employment Agreements

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

Leases

The Company leases office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. The terms of some of the Company s office leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

Guarantees and Indemnifications

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 June 29, 2008, the Company had $108.5 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.

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a Director and Officer Insurance Policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of June 29, 2008.

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 June 29, 2008.

11. Fair Value of Financial Instruments

The Company adopted SFAS 157 effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. SFAS 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. Although there was no impact for adoption of SFAS 157 to the consolidated financial statements, the Company is now required to provide additional disclosures as part of its financial statements. In accordance with FSP 157-2, the Company deferred adoption of SFAS 157 as it relates to nonfinancial assets and liabilities measured at fair value on a nonrecurring basis. SFAS 157 establishes a framework for measuring fair value and expands disclosure about fair value measurements. The statement requires fair value measurements be classified and disclosed in one of the following three categories:

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

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

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

The following table summarizes the valuation of the Company s financial instruments by the above SFAS 157 categories as of June 29, 2008:

	As of June 29, 2008			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents	$ 167,053	$ 167,053	$	$
Available-for-sale securities (1)	19,775	19,775		
Total	$ 186,828	$ 186,828	$	$

(1) Included in short-term investments on our condensed consolidated balance sheet.

The Company s investments in cash and cash equivalents and available-for-sale securities are recorded at fair value based on quoted market prices in active markets.

Table of Contents

The carrying value of other financial instruments, including, accounts receivable, and accounts payable approximate fair value due to their short maturities.

The Company monitors its investments for impairment by considering current factors, including the economic environment, market conditions, operational performance and other specific factors relating to the business underlying the investment, and records reductions in carrying values when necessary. Any impairment loss deemed to be other than temporary is reported under Other income (expense), net in the consolidated statement of operations.

Table of Contents

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

Forward-looking Statements

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

Overview

We design, develop and market innovative networking products that address the specific needs of small business and home users. We define small business as a business with fewer than 250 employees. We are focused on satisfying the ease-of-use, reliability, performance and affordability requirements of these users. Our product offerings enable users to share Internet access, peripherals, files, digital multimedia content and applications among multiple networked devices and other Internet-enabled devices.

Our product line consists of wired and wireless devices that enable Ethernet 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 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, Circuit City, Fry s Electronics, Radio Shack, Staples, Wal-Mart, Argos (U.K.), Dixons (U.K.), PC World (U.K.), MediaMarkt (Germany, Austria) and FNAC (France). Online retailers include Amazon.com, Newegg.com and Buy.com. Our DMRs include Dell, 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 in domestic markets and cable and DSL operators internationally. Some of these retailers and resellers purchase directly from us while most 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, the largest of which are Ingram Micro, Inc. and Tech Data Corporation. We expect that these wholesale distributors will continue to contribute a significant percentage of our net revenue for the foreseeable future.

Our net revenue grew 24.5% from the three months ended July 1, 2007 to the three months ended June 29, 2008. The increase in revenue was attributable to the addition of Wal-Mart as a retailer in the U.S. and higher sales in several of our product categories. These include gateway and wireless router products sold to new and existing service provider customers, ReadyNAS products, which were acquired in connection with our acquisition of Infrant Technologies, Inc. (Infrant) in May 2007, and switch products. We have also experienced growth in sales of our home wireless products.

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

Our gross margin decreased to 32.5% for the three months ended June 29, 2008, from 34.1% for the three months ended July 1, 2007. The decrease in gross margin percentage was primarily attributable to increased costs associated with end-user warranty returns.

Table of Contents

Operating expenses for the three months ended June 29, 2008 were $47.7 million, or 23.3% of net revenue, compared to $46.4 million, or 28.3% of net revenue, for the three months ended July 1, 2007.

Net income increased $5.0 million, or 80.4%, to $11.1 million for the three months ended June 29, 2008, from $6.1 million for the three months ended July 1, 2007. This increase was primarily attributable to an increase in gross profit of $10.4 million. This increase was offset by a decrease in interest income of $1.2 million, a decrease in other income (expense), net of $1.1 million, an increase in the provision for income taxes of $1.9 million, and an increase in operating expenses of $1.3 million.

On July 25, 2008, we ceased using our buildings leased in Santa Clara and Fremont, California, and consolidated all personnel and operations to a new facility in San Jose, California. We expect to sublease substantially all of our formerly-occupied space through the end of the operating leases, the longer of which extends to December 2010. However, sublessee payments will not completely offset the payments due under our original leases. As a result, we expect to recognize approximately $500,000 in expense related to future lease payments on the abandoned buildings during the three months ending September 28, 2008.

Results of Operations

The following table sets forth the consolidated statements of operations and the percentage change for the three and six months ended June 29, 2008, with the comparable reporting periods in the preceding year.

	Three Months Ended			Six Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)			(In thousands, except percentage data)		
Net revenue	$ 204,464	24.5%	$ 164,275	$ 402,618	19.2%	$ 337,847
Cost of revenue	138,055	27.4	108,321	272,346	22.8	221,863
Gross profit	66,409	18.7	55,954	130,272	12.3	115,984
Operating expenses:						
Research and development	8,584	24.2	6,909	17,322	32.6	13,065
Sales and marketing	31,192	9.7	28,421	64,220	14.2	56,247
General and administrative	7,877	13.4	6,948	15,190	9.6	13,862
In-process research and development		(100.0)	4,100		(100.0)	4,100
Litigation reserves, net		**		51	**	
Total operating expenses	47,653	2.7	46,378	96,783	10.9	87,274
Income from operations	18,756	95.9	9,576	33,489	16.6	28,710
Interest income	1,040	(52.6)	2,193	2,552	(44.1)	4,564
Other income (expense), net	(14)	**	1,148	2,829	99.2	1,420
Income before income taxes	19,782	53.1	12,917	38,870	12.0	34,694
Provision for income taxes	8,718	28.5	6,784	16,580	14.0	14,540
Net income	$ 11,064	80.4%	$ 6,133	$ 22,290	10.6%	$ 20,154

** Percentage change not meaningful as prior year basis is zero or a negative amount.

Table of Contents

The following table sets forth the condensed consolidated statements of operations, expressed as a percentage of net revenue, for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net revenue	100%	100%	100%	100%
Cost of revenue	67.5	65.9	67.6	65.7
Gross margin	32.5	34.1	32.4	34.3
Operating expenses:				
Research and development	4.2	4.2	4.3	3.9
Sales and marketing	15.3	17.3	16.0	16.6
General and administrative	3.8	4.3	3.8	4.1
In-process research and development	0.0	2.5	0.0	1.2
Litigation reserves, net	0.0	0.0	0.0	0.0
Total operating expenses	23.3	28.3	24.1	25.8
Income from operations	9.2	5.8	8.3	8.5
Interest income	0.5	1.4	0.7	1.4
Other income (expense), net	0.0	0.7	0.7	0.4
Income before income taxes	9.7	7.9	9.7	10.3
Provision for income taxes	4.3	4.2	4.2	4.3
Net income	5.4%	3.7%	5.5%	6.0%

Three Months Ended June 29, 2008 Compared to Three Months Ended July 1, 2007

Net Revenue

	Three Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Net revenue	$ 204,464	24.5%	$ 164,275

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 EITF Issue No. 01-9 and net changes in deferred revenue.

Net revenue increased $40.2 million, or 24.5%, to $204.5 million for the three months ended June 29, 2008, from $164.3 million for the three months ended July 1, 2007. The increase in revenue was attributable to the addition of Wal-Mart as a retailer in the U.S. and higher sales in several of our product categories. These include gateway and wireless router products sold to new and existing service provider customers, ReadyNAS products, which were acquired in connection with our acquisition of Infrant in May 2007, and switch products. We have also experienced growth in sales of our home wireless products.

In the three months ended June 29, 2008, net revenue generated within North America, Europe, Middle-East and Africa (EMEA) and Asia Pacific was 37.1%, 47.7% and 15.2%, respectively, of our total net revenue. The comparable net revenue for the three months ended July 1,

2007 was 37.6%, 51.8% and 10.6%, respectively, of our total net revenue. The increase in net revenue over the prior year comparable quarter for each region was 22.8%, 14.6% and 78.7%. The increase in Asia Pacific was primarily due to increased sales to service providers in that region.

Table of Contents

Cost of Revenue and Gross Margin

	Three Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Cost of revenue	$ 138,055	27.4%	$ 108,321
Gross margin percentage	32.5%		34.1%

Cost of revenue consists primarily of the following: the cost of finished products from our third party contract manufacturers; overhead costs including purchasing, product planning, inventory control, warehousing and distribution logistics; inbound freight; warranty costs associated with returned goods; write-downs for excess and obsolete inventory, and amortization expense of certain acquired intangibles. We outsource our manufacturing, warehousing and distribution logistics. We believe this outsourcing strategy allows us to better manage our product costs and gross margin. Our gross margin can be affected by a number of factors, including sales returns, changes in net revenues due to changes in average selling prices, end-user customer rebates and other sales incentives, and changes in our cost of goods sold due to fluctuations in prices paid for components, net of vendor rebates, warranty and overhead costs, inbound freight, conversion costs, and charges for excess or obsolete inventory and transitions from older to newer products.

Cost of revenue increased $29.8 million, or 27.4%, to $138.1 million for the three months ended June 29, 2008, from $108.3 million for the three months ended July 1, 2007. In addition, our gross margin decreased to 32.5% for the three months ended June 29, 2008, from 34.1% for the three months ended July 1, 2007, primarily attributable to increased costs associated with end-user warranty returns. These negative margin impacts were partially mitigated by certain gross margin improvements. We experienced an increase in sales of ReadyNAS products with higher gross margins, and we also experienced improvements in gross margins on broadband gateways sold to service providers during the three months ended June 29, 2008. Additionally, we incurred a $1.3 million expense in the three months ended July 1, 2007 related to inventory acquired from Infrant which was a one-time charge not repeated in future quarters.

Operating Expenses

Research and Development

	Three Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Research and development expense	$ 8,584	24.2%	$ 6,909
Percentage of net revenue	4.2%		4.2%

Research and development expenses consist primarily of personnel expenses, payments to suppliers for design services, tooling design costs, 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. We expect to continue to add additional employees in our research and development department. In the future, we believe that research and development expenses will increase in absolute dollars as we expand into new networking product technologies and broaden our core competencies.

Research and development expenses increased $1.7 million, or 24.2%, to $8.6 million for the three months ended June 29, 2008, from $6.9 million for the three months ended July 1, 2007. The increase was primarily attributable to increased salary, related payroll and other employee expenses of $1.0 million resulting from research and development related headcount growth in connection with our acquisition of Infrant. Included in the $1.0 million is an accrual of $484,000 for additional compensation payable in October 2008 related to our acquisition of Infrant subject to the achievement of certain ReadyNAS revenue targets. Employee headcount increased by 38% to 123 employees as of June 29, 2008 as compared to 89 employees as of July 1, 2007. Outside services costs increased $248,000. Additionally, stock-based compensation expense increased $334,000 to $863,000 for the three months ended June 29, 2008, from $529,000 for the three months ended July 1, 2007.

Table of Contents

Sales and Marketing

	Three Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Sales and marketing expense	$ 31,192	9.7%	$ 28,421
Percentage of net revenue	15.3%		17.3%

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. We believe that maintaining and building brand awareness is key to both net revenue growth and maintaining our gross margin. We also believe that maintaining widely available and high quality technical support is key to building and maintaining brand awareness. Accordingly, we expect sales and marketing expenses to increase in absolute dollars in the future, related to the expected growth of our business.

Sales and marketing expenses increased $2.8 million, or 9.7%, to $31.2 million for the three months ended June 29, 2008, from $28.4 million for the three months ended July 1, 2007. Of this increase, $1.6 million was attributable to increased salary, related payroll and other employee expenses as a result of sales and marketing related headcount growth and increased commissions. Employee headcount increased by 16% to 284 employees as of June 29, 2008 as compared to 244 employees as of July 1, 2007. Most of our increase in headcount occurred in connection with our expansion in EMEA and Asia Pacific. We have continued to expand our geographic market presence with investments in sales resources, and incurred a $571,000 increase in advertising, travel, and promotion expenses. Furthermore, outbound freight increased $586,000, reflecting our higher sales volume.

General and Administrative

	Three Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
General and administrative expense	$ 7,877	13.4%	$ 6,948
Percentage of net revenue	3.8%		4.3%

General and administrative expenses consist of salaries and related expenses for executive, finance and accounting, human resources, professional fees, allowance for doubtful accounts and other corporate expenses. We expect a modest increase in general and administrative costs in absolute dollars related to the growth of the business.

General and administrative expenses increased $929,000, or 13.4%, to $7.9 million for the three months ended June 29, 2008, from $6.9 million for the three months ended July 1, 2007. The increase was primarily attributable to increased fees of $762,000 for outside legal and other professional services. Furthermore, we incurred $547,000 in additional rent and depreciation expense, primarily related to our move to our new headquarters in San Jose, California. Additionally, stock-based compensation expense increased $234,000 to $978,000 for the three months ended June 29, 2008, from $744,000 for the three months ended July 1, 2007. Partially offsetting these increases was a reduction in salary, related payroll and other employee expenses of $780,000 due to a lower expense related to incentive compensation as well as the capitalization of certain employee costs associated with the implementation of our new enterprise resource planning system during the three months ended June 29, 2008.

Table of Contents

In-process Research and Development

During the three months ended July 1, 2007, we expensed $4.1 million for in-process research and development related to intangible assets purchased in our acquisition of Infrant. We did not incur any in-process research and development expense during the three months ended June 29, 2008.

Interest Income and Other Income (Expense), net

	Three Months Ended	
	June 29, 2008	July 1, 2007
	(In thousands)	
Interest income	$ 1,040	$ 2,193
Other income (expense), net	(14)	1,148
Total interest income and other income (expense), net	$ 1,026	$ 3,341

Interest income represents amounts earned on our cash, cash equivalents and short-term investments. Other income (expense), net primarily represents net gains and losses on transactions denominated in foreign currencies and other miscellaneous expenses.

Interest income decreased $1.2 million, or 52.6%, to $1.0 million for the three months ended June 29, 2008, from $2.2 million for the three months ended July 1, 2007. The decrease in interest income was primarily attributable to a decrease in the average interest rate earned in the three months ended June 29, 2008 as compared to the three months ended July 1, 2007.

Other income (expense), net decreased $1.1 million to an expense of $14,000 for the three months ended June 29, 2008, from income of $1.1 million for the three months ended July 1, 2007. We did not realize any foreign exchange gains in the three months ended June 29, 2008 due to relatively unchanged foreign exchanges rates during this period.

Provision for Income Taxes

The provision for income taxes increased $1.9 million, or 28.5%, to $8.7 million for the three months ended June 29, 2008, from $6.8 million for the three months ended July 1, 2007. The effective tax rate was approximately 44.1% for the three months ended June 29, 2008 and approximately 52.5% for the three months ended July 1, 2007. The decrease in the effective tax rate for the three months ended June 29, 2008 compared to the three months ended July 1, 2007 is primarily caused by non-deductible in-process research and development expense from the acquisition of Infrant in the second quarter of 2007 that is non-recurring in 2008. The decrease in the rate from the non-recurring expense is partially offset by increases in the mix of forecasted profits in jurisdictions with relatively higher tax rates for fiscal 2008 as compared to fiscal 2007. Additionally, provisions in the U.S. federal tax law allowing taxpayers to claim credits related to research and development activities expired on December 31, 2007. Accordingly, no benefit has been recorded in the three months ended June 29, 2008 for these credits.

Net Income

Net income increased $5.0 million, or 80.4%, to $11.1 million for the three months ended June 29, 2008, from $6.1 million for the three months ended July 1, 2007. This increase was primarily attributable to an increase in gross profit of $10.4 million. This increase was offset by a decrease in interest income of $1.2 million, a decrease in other income (expense), net of $1.1 million, an increase in the provision for income taxes of $1.9 million, and an increase in operating expenses of $1.3 million.

Table of Contents

Six Months Ended June 29, 2008 Compared to Six Months Ended July 1, 2007

Net Revenue

	Six Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Net revenue	$ 402,618	19.2%	$ 337,847

Net revenue increased $64.8 million, or 19.2%, to $402.6 million for the six months ended June 29, 2008, from $337.8 million for the six months ended July 1, 2007. The increase in revenue was attributable to the addition of Wal-Mart as a retailer in the U.S. and higher sales in several of our product categories. These include gateway and wireless router products sold to new and existing service provider customers, ReadyNAS products, which were acquired in connection with our acquisition of Infrant in May 2007, and switch products. We have also experienced growth in sales of our home wireless products.

In the six months ended June 29, 2008, net revenue generated within North America, EMEA and Asia Pacific was 38.5%, 48.6% and 12.9%, respectively, of our total net revenue. The comparable net revenue for the six months ended July 1, 2007 was 37.8%, 52.6% and 9.6%, respectively, of our total net revenue. The increase in net revenue over the prior year comparable period for each region was 21.3%, 10.1% and 60.4%. The increase in Asia Pacific was primarily due to increased sales to service providers in that region.

Cost of Revenue and Gross Margin

	Six Months Ended		
	June 29, 2008	Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Cost of revenue	$ 272,346	22.8%	$ 221,863
Gross margin percentage	32.4%		34.3%

Cost of revenue increased $50.4 million, or 22.8%, to $272.3 million for the six months ended June 29, 2008, from $221.9 million for the six months ended July 1, 2007. In addition, our gross margin decreased to 32.4% for the six months ended June 29, 2008, from 34.3% for the six months ended July 1, 2007, primarily attributable to increased sales of products carrying lower gross margins to service providers and retailers. Additionally, we incurred higher warranty costs associated with end-user warranty returns. These negative margin impacts were partially mitigated by certain gross margin improvements. We experienced an increase in sales of ReadyNAS products with higher gross margins. Additionally, we incurred a $1.3 million expense in the six months ended July 1, 2007 related to inventory acquired from Infrant which was a one-time charge not repeated in future quarters.

Operating Expenses

Research and Development

	June 29, 2008	Six Months Ended Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Research and development expense	$ 17,322	32.6%	$ 13,065
Percentage of net revenue	4.3%		3.9%

Research and development expenses increased $4.2 million, or 32.6%, to $17.3 million for the six months ended June 29, 2008, from $13.1 million for the six months ended July 1, 2007. The increase was primarily attributable to increased salary, related payroll and other employee expenses of $2.2 million resulting from research and development related headcount growth. Included in the $2.2 million was $1.9 million of incremental headcount expenses related to the acquisition of Infrant. Included in the $1.9 million is an accrual of $484,000 for additional compensation payable in October 2008 related to our acquisition of Infrant subject to the achievement of certain ReadyNAS revenue targets. Employee headcount increased by 38% to 123 employees as of June 29, 2008 as compared to 89 employees as of July 1, 2007. Non-recurring engineering costs increased $747,000 primarily due to incremental product development projects. Additionally, stock-based compensation expense increased $666,000 to $1.7 million for the six months ended June 29, 2008, from $1.0 million for the six months ended July 1, 2007.

Sales and Marketing

	June 29, 2008	Six Months Ended Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
Sales and marketing expense	$ 64,220	14.2%	$ 56,247
Percentage of net revenue	16.0%		16.6%

Sales and marketing expenses increased $8.0 million, or 14.2%, to $64.2 million for the six months ended June 29, 2008, from $56.2 million for the six months ended July 1, 2007. Of this increase, $4.1 million was attributable to increased salary, related payroll and other employee expenses as a result of sales and marketing related headcount growth and increased commissions. Employee headcount increased by 16% to 284 employees as of June 29, 2008 as compared to 244 employees as of July 1, 2007. Most of our increase in headcount occurred in connection with our expansion in EMEA and Asia Pacific. We have continued to expand our geographic market presence with investments in sales resources, and incurred a $1.7 million increase in advertising, travel, and promotion expenses. Furthermore, outbound freight increased $885,000, reflecting our higher sales volume. Additionally, stock-based compensation expense increased $190,000 to $1.7 million for the six months ended June 29, 2008, from $1.5 million for the six months ended July 1, 2007.

General and Administrative

	June 29, 2008	Six Months Ended Percentage Change	July 1, 2007
	(In thousands, except percentage data)		
General and administrative expense	$ 15,190	9.6%	$ 13,862
Percentage of net revenue	3.8%		4.1%

Table of Contents

General and administrative expenses increased $1.3 million, or 9.6%, to $15.2 million for the six months ended June 29, 2008, from $13.9 million for the six months ended July 1, 2007. We incurred $754,000 in additional rent and depreciation expense, primarily related to our move to our new headquarters in San Jose, California. Furthermore, we incurred higher fees of $553,000 for outside legal and accounting professional services. Additionally, stock-based compensation expense increased $539,000 to $1.9 million for the six months ended June 29, 2008, from $1.4 million for the six months ended July 1, 2007. Partially offsetting these increases was a reduction in salary, related payroll and other employee expenses of $337,000 due to a lower expense related to incentive compensation.

Litigation Reserves

During the six months ended June 29, 2008, we recorded net litigation reserves expense of $51,000, comprised of an expense of $109,000 for costs related to the settlement of the lawsuit filed by *Hybrid*, as well as a reduction in previously accrued legal costs of $58,000. For a detailed discussion of our litigation matters, please see Note 10 of the Notes to Unaudited Condensed Consolidated Financial Statements.

In-process Research and Development

During the six months ended July 1, 2007, we expensed $4.1 million for in-process research and development related to intangible assets purchased in our acquisition of Infrant. We did not incur any in-process research and development expense during the six months ended June 29, 2008.

Interest Income and Other Income

	Six Months Ended	
	June 29, 2008	July 1, 2007
	(In thousands)	
Interest income	$ 2,552	$ 4,564
Other income	2,829	1,420
Total interest income and other income	$ 5,381	$ 5,984

Interest income decreased $2.0 million, or 44.1%, to $2.6 million for the six months ended June 29, 2008, from $4.6 million for the six months ended July 1, 2007. The decrease in interest income was primarily attributable to a decrease in the average interest rate earned in the six months ended June 29, 2008 as compared to the six months ended July 1, 2007.

Other income increased $1.4 million, or 99.2%, to $2.8 million for the six months ended June 29, 2008, from $1.4 million for the six months ended July 1, 2007. The increase in other income was primarily attributable to higher foreign exchange gains experienced due to the relatively greater weakening of the U.S. dollar against the euro in the six months ended June 29, 2008 compared to the six months ended July 1, 2007. Additionally, the U.S. dollar weakened against the Japanese yen, British pound, and Australian dollar in the six months ended June 29, 2008 at a greater rate than during the six months ended July 1, 2007.

Provision for Income Taxes

The provision for income taxes increased $2.1 million, or 14.0%, to $16.6 million for the six months ended June 29, 2008, from $14.5 million for the six months ended July 1, 2007. The effective tax rate was approximately 42.7% for the six months ended June 29, 2008 and approximately 41.9% for the six months ended July 1, 2007. The increase in the effective tax rate for the six months ended June 29, 2008 compared to the six months ended July 1, 2007 is primarily caused by increases in the mix of forecasted profits in jurisdictions with relatively higher tax rates for fiscal 2008 as compared to fiscal 2007, offset by a decrease due to non-deductible in-process research and development expense from the acquisition of Infrant in the second quarter of 2007 that is non-recurring in 2008. Additionally, provisions in the U.S. federal tax law allowing taxpayers to claim credits related to research and development activities expired on December 31, 2007. Accordingly, no benefit has been recorded in the six months ended June 29, 2008 for these credits.

Table of Contents

Net Income

Net income increased $2.1 million, or 10.6%, to $22.3 million for the six months ended June 29, 2008, from $20.2 million for the six months ended July 1, 2007. This increase was primarily attributable to an increase in gross profit of $14.3 million. This increase was offset by an increase in operating expenses of $9.5 million, and a decrease in interest income of $2.0 million.

Liquidity and Capital Resources

As of June 29, 2008, we had cash, cash equivalents and short-term investments totaling $186.8 million. Short-term investments accounted for $19.8 million of this balance.

Our cash and cash equivalents balance decreased from $167.5 million as of December 31, 2007 to $167.1 million as of June 29, 2008. Operating activities during the six months ended June 29, 2008 used cash of $8.5 million. Investing activities during the six months ended June 29, 2008 provided $6.5 million, primarily from the net proceeds from the sale of short-term investments, offset by purchases of property and equipment amounting to $11.5 million. Purchases of property and equipment primarily consisted of approximately $4.7 million related to our move to a new headquarters facility in San Jose, California and approximately $4.6 million related to our new enterprise resource planning software. During the six months ended June 29, 2008, financing activities provided $1.5 million, resulting primarily from the issuance of common stock related to stock option exercises and our employee stock purchase program, as well as the excess tax benefit from exercise of stock options.

Our days sales outstanding decreased from 73 days as of December 31, 2007 to 71 days as of June 29, 2008.

Our accounts payable decreased from $55.3 million at December 31, 2007 to $46.4 million at June 29, 2008. The decrease of $8.9 million is primarily attributable to relative timing of payments.

Inventory increased by $23.4 million from $83.0 million at December 31, 2007 to $106.4 million at June 29, 2008. In the three months ended June 29, 2008 we experienced annual ending inventory turns of approximately 5.2, down from approximately 6.5 in the three months ended December 31, 2007. This decrease is primarily attributable to our increase in inventory levels in preparation for our promotional activities in the third quarter of 2008.

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. The terms of certain of our facility leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period, and have accrued for rent expense incurred but not paid.

We enter into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of the orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. At June 29, 2008, we had approximately $108.5 million in non-cancelable purchase commitments with suppliers. We establish a loss liability for all products we do not expect to sell for which we have committed purchases from suppliers. Such losses have not been material to date.

Contractual Obligations and Off-Balance Sheet Arrangements

The following table describes our commitments to settle contractual obligations and off-balance sheet arrangements in cash as of June 29, 2008 (in thousands):

Contractual Obligations	Less than 1 Year	1 - 3 Years	3 - 5 Years	Over 5 Years	Total
Operating leases	$ 5,688	$ 9,772	$ 11,529	$ 13,400	$ 40,389
Purchase obligations	108,463				108,463
	$ 114,151	$ 9,772	$ 11,529	$ 13,400	$ 148,852

As of June 29, 2008, we did not have any off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

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 will 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.

As of June 29, 2008, the liability for uncertain tax positions, net of federal effect on tax issues, is $11.2 million. The timing of payment cannot be estimated. We do not expect a significant tax payment related to these obligations to occur within the next 12 months.

Critical Accounting Policies and Estimates

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007. Our critical accounting policies have not materially changed during the six months ended June 29, 2008.

Item 3. *Quantitative and Qualitative Disclosures About Market 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 short-term securities. 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 are exposed to risks associated with foreign exchange rate fluctuations due to our international manufacturing and sales activities. We generally have not hedged currency exposures. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. In the second quarter of 2005 we began to invoice some of our international customers in foreign currencies including but not limited to, the euro, British pound, Japanese yen and the Australian dollar. 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 could reduce sales and negatively impact our operating results. Certain operating expenses of our foreign operations require payment in the local currencies. As of June 29, 2008, we had net receivables in various local currencies. A hypothetical 10% movement in foreign exchange rates would result in an after-tax positive or negative impact of $3.9 million to net income at June 29, 2008. For the three and six months ended June 29, 2008, 36.5% and 33.2%, respectively, of total net revenue was earned in currency other than U.S. dollars.

Item 4. *Controls and Procedures*

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

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

Item 1. ***Legal Proceedings***

The information set forth under Note 10 of the Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled Risk Factors in Item 1A of this report.

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.

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 revenue 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 this 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;
- changes in the terms of our contracts with customers or suppliers that cause us to incur additional expenses or assume additional liabilities;
- slow or negative growth in the networking product, personal computer, Internet infrastructure, home electronics and related technology markets, as well as decreased demand for Internet access;
- 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;
- disruptions or delays related to implementation of our new financial and enterprise resource planning systems;
- our inability to accurately forecast product demand;
- unfavorable level of inventory and turns;

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

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

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

challenges associated with integrating acquisitions that we make;

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

seasonal patterns of higher sales during the second half of our fiscal year, particularly retail-related sales in our fourth quarter;

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

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

bad debt exposure as we expand into new international markets; 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. In addition, our future operating results may fall below the expectations of public market analysts or investors. In that event, our stock price could decline significantly.

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 highly competitive market, and we expect competition to intensify. Our principal competitors in the small business market include 3Com, Allied Telesyn, Buffalo, Dell, D-Link, Hewlett-Packard, Huawei, the Linksys division of Cisco Systems, Nortel Networks and SonicWALL. Our principal competitors in the home market include Apple, Belkin, D-Link and the Linksys division of Cisco Systems. Our principal competitors in the broadband service provider market include Actiontec, ARRIS, Comtrend, Motorola, Sagem, Scientific Atlanta, a Cisco company, ZyXEL, Thomson and 2Wire. Other current and potential competitors include numerous local vendors such as Siemens and AVM in Europe, Corega and Melco in Japan and TP-Link in China. Our potential competitors also include consumer electronics vendors who could integrate networking capabilities into their line of products, 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.

Many of our existing and potential competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. These competitors may, among other things, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, obtain more favorable pricing from suppliers and manufacturers, and exert more influence on sales channels than we can. We anticipate that current and potential competitors will also intensify their efforts to penetrate our target markets. These competitors may have more advanced technology, more extensive distribution channels, stronger brand names, greater access to shelf space in retail locations, bigger promotional budgets and larger customer bases than we do. These companies could devote more capital resources to develop, manufacture and market competing products than we could. If any of these companies are successful in competing against us, our sales could decline, our margins could be negatively impacted and we could lose market share, any of which could seriously harm our business and results of operations.

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

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

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

preferred method, and suffering a corresponding decline in gross margins.

We are currently involved in various 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 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 include third parties 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. Also, at any time, any of these companies, or any other third party could initiate litigation against us, or we may be forced to initiate litigation against them, which could divert management attention, be costly to defend or prosecute, prevent us from using or selling the challenged technology, require us to design around the challenged technology and cause the price of our stock to decline. In addition, third parties, some of whom are potential competitors, have initiated and may continue to initiate litigation against our manufacturers, suppliers, members of our sales channels or our service provider customers, alleging infringement of their proprietary rights with respect to existing or future products. In the event successful claims of infringement are brought by third parties, and we are unable to obtain licenses or independently develop alternative technology on a timely basis, we may be subject to indemnification obligations, be unable to offer competitive products, or be subject to increased expenses. Finally, consumer class-action lawsuits related to the marketing and performance of our home networking products have been asserted and may in the future be asserted against us. For additional information regarding certain of the lawsuits in which we are involved, see Legal Proceedings, contained in Part I, Item 1, Note 10 of the Notes to Unaudited Condensed Consolidated Financial Statements, which information is incorporated into this Item 1A by reference. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly 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. For example, in January 2008, we announced a voluntary recall of the XE103 Powerline Ethernet Adapter made for Europe and other countries using 220-240 volt power sources and sold individually or in a bundled kit. If our products contain defects or errors, or are found to be noncompliant with industry standards, we could experience decreased sales and increased product returns, loss of customers and market share, and increased service, warranty and insurance costs. In addition, our reputation and brand could be damaged, and we could face legal claims regarding our products. A product liability or other claim could result in negative publicity and harm our reputation, resulting in unexpected expenses and adversely impact our operating results.

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

Our products typically experience price erosion, a fairly rapid reduction in the average selling prices over their respective sales cycles. In order to sell products that have a falling average 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.

Table of Contents

Our future success is dependent on the growth in personal computer sales and the acceptance of networking products in the small business and home markets into which we sell substantially all of our products. If the acceptance of networking products in these markets does not continue to grow, we will be unable to increase or sustain our net revenue, and our business will be severely harmed.

We believe that growth in the small business market will depend, in significant part, on the growth of the number of personal computers purchased by these end-users and the demand for sharing data intensive applications, such as large graphic files. We believe that acceptance of networking products in the home will depend upon the availability of affordable broadband Internet access and increased demand for wireless products. Unless these markets continue to grow, our business will be unable to expand, which could cause the value of our stock to decline. Moreover, if networking functions are integrated more directly into personal computers and other Internet-enabled devices, such as electronic gaming platforms or personal video recorders, and these devices do not rely upon external network-enabling devices, sales of our products could suffer. In addition, if the small business or home markets experience a recession or other cyclical effects that diminish or delay networking expenditures, our business growth and profits would be severely limited, and our business could be more severely harmed than those companies that primarily sell to large business customers.

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

We operate in a highly competitive, quickly changing environment, and our future success depends on our ability to develop and introduce new products that achieve broad market acceptance in the small business and home markets. Our future success will depend in large part upon our ability to identify demand trends in the small business and home markets and quickly develop, manufacture and sell products that satisfy these demands in a cost effective manner. Successfully predicting demand trends is difficult, and it is very difficult to predict the effect introducing a new product will have on existing product sales. We will also need to respond effectively to new product announcements by our competitors by quickly introducing competitive products.

We have experienced delays and quality issues in releasing new products in the past, which resulted in lower quarterly net revenue than expected. In addition, we have experienced, and may in the future experience, product introductions that fall short of our projected rates of market adoption. Any future delays in product development and introduction or product introductions that do not meet broad market acceptance could result in:

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and brand;
- a decline in the average selling price of our products;
- 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.

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. We sell our products through our sales channels, which consists of traditional retailers, online retailers, DMRs, VARs, and broadband service providers. Some of these entities purchase our products through our wholesale distributors. We generally have no minimum purchase commitments or long-term contracts with any of these third parties.

Traditional retailers have limited shelf space and promotional budgets, and competition is intense for these resources. If the networking sector does not experience sufficient growth, retailers may choose to allocate more shelf space to other consumer product sectors. A competitor with more extensive product lines and stronger brand identity, such as Cisco Systems, may have greater bargaining power with these retailers. Any

reduction in available shelf space or increased competition for such shelf space would require us to increase our marketing expenditures simply to maintain current levels of retail shelf space, which would harm our operating margin. The recent trend in the consolidation of online retailers and DMR channels has resulted in intensified competition

for preferred product placement, such as product placement on an online retailer s Internet home page. Expanding our presence in the VAR channel may be difficult and expensive. We compete with established companies that have longer operating histories and longstanding relationships with VARs that we would find highly desirable as sales channel partners. We have limited experience selling to broadband service providers. Penetrating service provider accounts typically involves a long sales cycle and the challenge of displacing incumbent suppliers with established relationships and field-deployed products. If we were unable to maintain and expand our sales channels, our growth would be limited and our business would be harmed.

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

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

We sell a substantial portion of our products through broadband service providers worldwide. We face a number of challenges associated with penetrating, marketing and selling to the broadband service provider channel that differ from what we have traditionally faced with the other channels. These challenges include a longer sales cycle, more stringent product testing and validation requirements, a higher level of systems and networking engineering support 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 our general inexperience in selling to service providers. 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. 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. 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 guidance for a particular period of time and therefore adversely affect our stock price. In addition, service providers may choose to prioritize the implementation of other technologies or the roll out of other services than home networking. Any slowdown in the general economy, over capacity, consolidation among service providers, regulatory developments and constraint on capital expenditures could result in reduced demand from service providers and therefore adversely affect our sales to them. If we do not successfully overcome these challenges, we will not be able to profitably grow our service provider sales channel and our growth will be slowed.

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

Any shortage or delay in the supply of key product components would harm our ability to meet scheduled product deliveries. Many of the semiconductors used in our products are specifically designed for use in our products and are obtained from sole source suppliers on a purchase order basis. In addition, some components that are used in all our products are obtained from limited sources. These components include connector jacks, plastic casings and physical layer transceivers. We also obtain switching fabric semiconductors, which are used in our Ethernet switches and Internet gateway products, and wireless local area network chipsets, which are used in all of our wireless products, from a limited number of suppliers. Semiconductor suppliers have experienced and continue to experience component shortages themselves, such as with substrates used in manufacturing chipsets, which in turn adversely impact our ability to procure semiconductors from them. Our third party manufacturers generally purchase these components on our behalf on a purchase order basis, and we do not have any contractual commitments or guaranteed supply arrangements with our suppliers. If demand for a specific component increases, we may not be able to obtain an adequate number of that component in a timely manner. In addition, if our suppliers experience financial or other difficulties or if worldwide demand for the components they provide increases significantly, the availability of these components could be limited. It could be difficult, costly and time consuming to obtain alternative sources for these components, or to change product designs to make use of alternative components. In addition, difficulties in transitioning from an existing supplier to a new supplier could create delays in component availability that would have a significant impact on our ability to fulfill orders for our products. If we are unable to obtain a sufficient supply of components, or if we experience any interruption in the supply of components, our product shipments could be reduced or delayed. This would affect our ability to meet scheduled product deliveries, damage our brand and reputation in the market, and cause us to lose market share.

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.

Although a significant portion of our international sales are currently invoiced in United States dollars, we have implemented and continue to implement for certain countries both invoicing and payment in foreign currencies. Recently, we have experienced currency exchange gains; however, our exposure to adverse foreign currency rate fluctuations will likely increase. We currently do not engage in any currency hedging transactions. Moreover, the costs of doing business abroad may increase as a result of adverse exchange rate fluctuations. For example, if the United States dollar declined in value relative to a local currency, we could be required to pay more in U.S. dollar terms for our expenditures in that market, including salaries, commissions, local operations and marketing expenses, each of which is paid in local currency. In addition, we may lose customers if exchange rate fluctuations, currency devaluations or economic crises increase the local currency prices of our products or reduce our customers ability to purchase products.

Rising oil prices, unfavorable economic conditions, particularly in the United States and Western Europe, and turmoil in the international geopolitical environment may adversely affect our operating results.

A deterioration in global economic and market conditions may lead to slowdowns in expenditures for networking equipment, resulting in reduced product demand, increased price competition and higher excess inventory levels. Recently, economic conditions in the United States and Western Europe have been challenged by slowing growth and the sub-prime debt devaluation crisis. Furthermore, turmoil in the global geopolitical environment, including the ongoing tensions in Iraq and the Middle-East, has pressured and continues to pressure global economies. In addition, rising oil prices may result in a reduction in consumer spending and an increase in freight costs to us. If the global economic climate does not improve, our business and operating results will be harmed.

We have been upgrading our new financial, demand planning and operational management systems, and anticipate transacting on them in the near future. If we experience problems with the initial deployment and operation of these new systems, our business and operations will be adversely affected.

We are in the process of upgrading our financial and enterprise resource planning systems and anticipate transacting on the new systems in the near future. We have invested, and will continue to invest, significant capital and human resources in their design and implementation, which may be disruptive to our underlying business. If we experience any disruptions or delays in their implementation, 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 design and implementation of the new systems may be much more costly than we anticipated. If we are unable to successfully design and implement the new IT systems as planned, our financial position, results of operations and cash flows could be negatively impacted.

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 have a more material effect on our business than at the beginning of a quarter.

The transportation network is subject to disruption or congestion from a variety of causes, including labor disputes or port strikes, acts of war or terrorism, natural disasters and congestion resulting from higher shipping volumes. Labor disputes among freight carriers and at ports of entry are common, especially in Europe, and we expect labor unrest and its effects on shipping our products to be a continuing challenge for us. The labor unions for the ports in the west coast of the U.S. are now engaging in contract negotiation with the port operators. If the negotiation does not go smoothly and results in strikes in 2008, it will severely impact our business. Since September 11, 2001, the rate of inspection of international freight by governmental entities has substantially increased, and has become increasingly unpredictable. 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. In addition, if the increases in fuel prices were to continue, our transportation costs would likely further 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 air freight to meet unexpected spikes in demand or to bring new product introductions to market quickly. If we rely more heavily upon air freight to deliver our products, our overall shipping costs will increase. A prolonged transportation disruption or a significant increase in the cost of freight could severely disrupt our business and harm our operating results.

33

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

We sell a substantial portion of our products through wholesale distributors, including Ingram Micro, Inc. and Tech Data Corporation. During the fiscal quarter ended June 29, 2008, sales to Ingram Micro and its affiliates accounted for 13% of our net revenue and sales to Tech Data and its affiliates accounted for 11% of our net revenue. We expect that a significant portion of our net revenue will continue to come from sales to a small number of wholesale distributors for the foreseeable future. In addition, because our accounts receivable are concentrated with a small group of purchasers, the failure of any of them to pay on a timely basis, or at all, would reduce our cash flow. We generally have no minimum purchase commitments or long-term contracts with any of these distributors. These purchasers could decide at any time to discontinue, decrease or delay their purchases of our products. In addition, the prices that they pay for our products are subject to negotiation and could change at any time. If any of our major wholesale distributors reduce their level of purchases or refuse to pay the prices that we set for our products, our net revenue and operating results could be harmed. If our wholesale distributors increase the size of their product orders without sufficient lead-time for us to process the order, our ability to fulfill product demands would be compromised.

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, or if stock market analysts or our stockholders do not support the acquisitions that we choose to execute, 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. Acquisitions involve numerous risks and challenges, including but not limited to the following:

- integrating the companies, assets, systems, products, sales channels and personnel that we acquire;
- growing or maintaining revenues to justify the purchase price and the increased expenses associated with acquisitions;
- entering into territories or markets that we have limited or no prior experience with;
- establishing or maintaining business relationships with customers, vendors and suppliers who may be new to us;
- overcoming the employee, customer, vendor and supplier turnover that may occur as a result of the acquisition; and
- diverting management s attention from running the day to day operations of our business.

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 in-process research and development expenses being charged in an individual quarter, which results in variability in our quarterly earnings. In addition, our effective tax rate in any particular quarter may also be impacted by acquisitions.

We cannot assure you 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.

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

As a result of our acquisitions, we have significant goodwill and amortizable intangible assets recorded on our balance sheet. Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered

when determining if the carrying value of our goodwill or amortizable intangible assets may not be recoverable include market conditions, operating fundamentals, competition and general economic conditions. We may incur substantial impairment charges to earnings in our financial statements during the period should an impairment of our goodwill or amortizable intangible assets be determined resulting in an adverse impact on our results of operations.

Our income tax provision and liability for uncertain tax positions may be insufficient if any taxing authorities are successful in asserting tax positions that are contrary to our positions.

Significant judgment is required to determine our provision for income taxes and liability for uncertain tax positions. In the ordinary course of our business, there may be matters for which the ultimate tax outcome is uncertain. Although we believe our approach to determining the appropriate tax treatment is reasonable, no assurance can be given that the final tax authority determination will not be materially different than that which is reflected in our income tax provision and liability for uncertain tax positions. Such differences could have a material adverse effect on our income tax provision or benefit and liability for uncertain tax positions in the period in which such determination is made and, consequently, on our net income for such period.

From time to time, we are audited by various federal, state and foreign authorities regarding tax matters. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit and, in some cases, appeal or litigation process. As each audit is concluded, adjustments, if any, are appropriately recorded in our financial statements in the period determined. To provide for potential tax exposure, we maintain a liability for uncertain tax positions in accordance with FIN 48. However, if these accrued liabilities and/or reserves are insufficient upon completion of any audit process, there could be an adverse impact on our financial position and results of operations.

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

All of our products are manufactured, assembled, tested and generally packaged by a limited number of original design manufacturers (ODMs), contract manufacturers (CMs) and original equipment manufacturers (OEMs). We rely on our manufacturers to procure components and, in some cases, subcontract engineering work. Some of our products are manufactured by a single manufacturer. We do not have any long-term contracts with any of our third party manufacturers. Some of these third party manufacturers produce products for our competitors. 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.

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

- unexpected increases in manufacturing and repair costs;
- inability to control the quality of finished products;
- inability to control delivery schedules; and
- potential lack of adequate capacity to manufacture all or a part of the products we require.

All of our products must satisfy safety and regulatory standards and some of our products must also receive government certifications. Our ODMs, CMs and OEMs are primarily responsible for obtaining most regulatory approvals for our products. If our ODMs, CMs and OEMs fail to obtain timely domestic or foreign regulatory approvals or certificates, we would be unable to sell our products and our sales and profitability could be reduced, our relationships with our sales channel could be harmed, and our reputation and brand would suffer.

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

We provide our third party manufacturers with a rolling forecast of demand, which they use to determine our material and component requirements. Lead times for ordering materials and components vary significantly and depend on various factors, such as the specific supplier, contract terms and demand and supply for a component at a given time. Some of our components have long lead times, such as wireless local area network chipsets, switching fabric chips, physical layer transceivers, connector jacks and metal and plastic enclosures. If our forecasts are not timely provided or are less than our actual requirements, our third party manufacturers may be unable to manufacture products in a timely

manner. If our forecasts are too high, our third party manufacturers will be unable to use the components they have purchased on our behalf. The cost of the components used in our products tends to drop rapidly as volumes increase and the technologies mature. Therefore, if our third party manufacturers are unable to promptly use components purchased on our behalf, our cost of producing products may be higher than our competitors due to an oversupply of higher-priced components. Moreover, if they are unable to use components ordered at our direction, we will need to reimburse them for any losses they incur.

Table of Contents

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 advanced 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 may be lower than if we owned exclusive rights to the technology we license and use. On the other hand, 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 which 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. Our licenses often require royalty payments or other consideration to third parties. Our success will depend in part on our continued ability to have access to these technologies, and we do not know whether these third party technologies will continue to be licensed to us on commercially acceptable terms or 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. This 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 that we require of them, we may experience delays in releasing new products or difficulties with supporting existing products and customers.

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 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, especially in those international markets where our intellectual property rights may be less protected. Furthermore, our competitors may independently develop similar technology or design around our intellectual property. Our inability to secure and protect our intellectual property rights could significantly harm our brand and business, operating results and financial condition.

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

International sales comprise a significant amount of our overall net revenue. International sales were 62% of overall net revenue in fiscal 2007. We anticipate that international sales may grow as a percentage of net revenue. We have committed resources to expanding our international operations and sales channels and these efforts may not be successful. International operations are subject to a number of other risks, including:

- political and economic instability, international terrorism and anti-American sentiment, particularly in emerging markets;
- preference for locally branded products, and laws and business practices favoring local competition;
- exchange rate fluctuations;
- increased difficulty in managing inventory;
- delayed revenue recognition;

less effective protection of intellectual property;

stringent consumer protection and product compliance regulations, including but not limited to the recently enacted Restriction of Hazardous Substances directive and the Waste Electrical and Electronic Equipment directive in Europe, that may vary from country to country and that are costly to comply with;

difficulties and costs of staffing and managing foreign operations; and

changes of local tax laws.

We intend to expand our operations and infrastructure, which may strain our operations and increase our operating expenses.

We intend to expand our operations and pursue market opportunities domestically and internationally to grow our sales. We expect that this attempted expansion will strain 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 these 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, our business could be harmed.

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

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

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to furnish a report by our management on our internal control over financial reporting. Such report must contain among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

We will continue to perform the system and process documentation and evaluation needed to comply with Section 404, which 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.

We are continuing to implement our international reorganization, which is straining our resources and increasing our operating expenses.

We have been reorganizing our foreign subsidiaries and entities to better manage and optimize our international operations. Our implementation of this project requires substantial efforts by our staff and is resulting in increased staffing requirements and related expenses. Failure to successfully execute the reorganization or other factors outside of our control could negatively impact the timing and extent of any benefit we receive from the reorganization.

We recently moved into a new corporate headquarters facility in the third quarter of 2008. If we do not successfully execute the office move, we may experience disruptions to our business. In addition, if we cannot find a sub lessee for the remaining lease term of our old facilities, then we will be forced to take a charge related to such excess space.

In September 2007 we entered into a lease for a new corporate headquarters facility that occupies approximately 142,700 square feet in San Jose, California, under a lease that commences in April 2008 and expires in March 2018. We recently moved into the new facility in the third quarter of 2008. We face a number of challenges associated with the move, including ensuring accounting, engineering, IT, order processing and phone systems are fully operational, and minimizing any employee downtime. If we do not successfully execute our facilities move, then we may experience business interruptions which could have a detrimental effect on our operating results in the third quarter of 2008.

In addition, the existing lease on our former Santa Clara headquarters facility does not expire until the end of 2010 and the existing lease on our Fremont facility does not expire until the end of October 2009. We intend to sublease these facilities during the remaining term of the lease. If we are unsuccessful in finding sub lessees, then we will have to take a charge associated with such excess space.

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

With the continuing uncertainty about economic conditions in the United States, 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;
- interest rate or currency exchange rate fluctuations;
- our ability or inability to raise additional capital; and
- changes in stock market analyst recommendations regarding our common stock, other comparable companies or our industry generally.

Natural disasters, mischievous actions or terrorist attacks could delay our ability to receive or ship our products, or otherwise disrupt our business.

Our corporate headquarters are located in Northern California and one of our warehouses is located in Southern California, regions known for seismic activity. 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. Moreover, if our computer information systems or communication systems, or those of our vendors or customers, are subject to disruptive hacker attacks or other disruptions, our business could suffer. We have not established a formal disaster recovery plan. Our back-up operations may be inadequate and our business interruption insurance may not be enough to compensate us for any losses that may occur. A significant business interruption could result in losses or damages and harm our business. For example, much of our order fulfillment process is automated and the order information is stored on our servers. If our computer systems and servers go down even for a short period at the end of a fiscal quarter, our ability to recognize revenue would be delayed until we were again able to process and ship our orders, which could cause our

stock price to decline significantly.

Table of Contents

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 and senior management personnel. In particular, the services of Patrick C.S. Lo, our Chairman and Chief Executive Officer, who has led our company since its inception, are very important to our business. We do not maintain any key person life insurance policies. The loss of any of our senior management or other key research, development, sales or marketing personnel, particularly if lost to competitors, could harm our ability to implement our business strategy and respond to the rapidly changing needs of the small business and home markets.

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

We repurchased and retired certain shares related to the vesting of restricted stock units during the three months ended June 29, 2008. A summary of our common stock repurchases during the three months ended June 29, 2008 is set forth in the following table. All such shares of common stock were repurchased pursuant to open market transactions.

Period	Total number of shares repurchased	Average price paid per share ($)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that may Yet Be Purchased Under the Plans or Programs
Fiscal April 2008				N/A
Fiscal May 2008	1,403	18.40		N/A
Fiscal June 2008				N/A
	1,403	18.40		

Item 3. ***Defaults Upon Senior Securities***

None.

Item 4. ***Submission of Matters to a Vote of Security Holders***

Our 2008 Annual Meeting of Stockholders was held on June 3, 2008. Of the 35,342,587 shares of our capital stock entitled to vote at the meeting, 32,064,231 were present in person or by proxy. Our stockholders approved the following matters:

1. Election of Directors

Nominee	For	Withheld
Patrick C.S. Lo	30,828,103	1,236,128
Ralph E. Faison	30,842,153	1,222,078
A. Timothy Godwin	30,949,900	1,114,331
Jef Graham	30,841,412	1,222,819
Linwood A. Lacy, Jr.	30,946,693	1,117,538
George G. C. Parker	30,761,305	1,302,926
Gregory J. Rossmann	30,838,382	1,225,849
Julie A. Shimer	30,835,726	1,228,505

2. Approval of Amendments to the NETGEAR, Inc. 2006 Long-Term Incentive Plan

A proposal for the approval of amendments to our 2006 Long-Term Incentive Plan was approved by a vote of 22,134,723 for, 4,204,241 votes against and 935,076 votes abstaining.

3. Approval of the Adoption of the NETGEAR, Inc. Executive Bonus Plan

Table of Contents

A proposal for the approval of the adoption of our Executive Bonus Plan was approved by a vote of 25,900,002 for, 431,536 votes against and 942,502 votes abstaining.

4. Ratification of Appointment of Independent Registered Public Accounting Firm

A proposal for the ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008 was approved by a vote of 31,012,443 for, 63,195 votes against and 988,593 votes abstaining.

Item 6. ***Exhibits***

Exhibit Number	Description
10.1	Amended and Restated 2006 Long-Term Incentive Plan (incorporated by reference to Appendix A of the Company s definitive proxy statement filed with the Securities and Exchange Commission on April 28, 2008).
10.2	NETGEAR, Inc. Executive Bonus Plan (incorporated by reference to Appendix B of the Company s definitive proxy statement filed with the Securities and Exchange Commission on April 28, 2008).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
32.1	Section 1350 Certification of Principal Executive Officer
32.2	Section 1350 Certification of Principal Financial Officer

Table of Contents

SIGNATURES

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

NETGEAR, INC.

Registrant

/s/ CHRISTINE M. GORJANC
Christine M. Gorjanc

Chief Financial Officer

(Principal Financial and Accounting Officer)

Date: August 8, 2008

Table of Contents

Exhibit Index

Exhibit Number	Description
10.1	Amended and Restated 2006 Long-Term Incentive Plan (incorporated by reference to Appendix A of the Company s definitive proxy statement filed with the Securities and Exchange Commission on April 28, 2008).
10.2	NETGEAR, Inc. Executive Bonus Plan (incorporated by reference to Appendix B of the Company s definitive proxy statement filed with the Securities and Exchange Commission on April 28, 2008).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
32.1	Section 1350 Certification of Principal Executive Officer
32.2	Section 1350 Certification of Principal Financial Officer