

NETGEAR, INC  
Form 10-Q  
July 31, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

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

For the quarterly period ended June 28, 2015.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-50350

NETGEAR, Inc.

(Exact name of registrant as specified in its charter)

Delaware 77-0419172  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

350 East Plumeria Drive, 95134  
San Jose, California  
(Address of principal executive offices) (Zip Code)

(408) 907-8000

(Registrant's telephone number including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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  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

The number of outstanding shares of the registrant's Common Stock, \$0.001 par value, was 32,143,178 as of July 24, 2015.

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## PART I: FINANCIAL INFORMATION

## Item 1. Financial Statements

## NETGEAR, INC.

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

|   | June 28,<br>2015 | December 31,<br>2014 |
|---|------------------|----------------------|
| <b>ASSETS</b>                                 |                  |                      |
| Current assets:                               |                  |                      |
| Cash and cash equivalents                     | \$136,755        | \$141,234            |
| Short-term investments                        | 76,160           | 115,895              |
| Accounts receivable, net                      | 246,493          | 275,689              |
| Inventories                                   | 188,668          | 222,883              |
| Deferred income taxes                         | 26,476           | 29,039               |
| Prepaid expenses and other current assets     | 39,133           | 38,225               |
| Total current assets                          | 713,685          | 822,965              |
| Property and equipment, net                   | 25,591           | 29,694               |
| Intangibles, net                              | 57,434           | 66,230               |
| Goodwill                                      | 81,721           | 81,721               |
| Other non-current assets                      | 48,352           | 48,077               |
| Total assets                                  | \$926,783        | \$1,048,687          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                  |                      |
| Current liabilities:                          |                  |                      |
| Accounts payable                              | \$71,217         | \$106,357            |
| Accrued employee compensation                 | 18,588           | 21,588               |
| Other accrued liabilities                     | 123,847          | 143,742              |
| Deferred revenue                              | 28,412           | 30,023               |
| Income taxes payable                          | —                | 2,406                |
| Total current liabilities                     | 242,064          | 304,116              |
| Non-current income taxes payable              | 15,551           | 15,252               |
| Other non-current liabilities                 | 9,280            | 7,754                |
| Total liabilities                             | 266,895          | 327,122              |
| Commitments and contingencies (Note 7)        |                  |                      |
| Stockholders' equity:                         |                  |                      |
| Common stock                                  | 32               | 35                   |
| Additional paid-in capital                    | 467,730          | 454,144              |
| Accumulated other comprehensive income (loss) | (57              | ) 38                 |
| Retained earnings                             | 192,183          | 267,348              |
| Total stockholders' equity                    | 659,888          | 721,565              |
| Total liabilities and stockholders' equity    | \$926,783        | \$1,048,687          |

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

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NETGEAR, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|   | Three Months Ended |                  | Six Months Ended |                  |   |
|---|--------------------|------------------|------------------|------------------|---|
|   | June 28,<br>2015   | June 29,<br>2014 | June 28,<br>2015 | June 29,<br>2014 |   |
| Net revenue   | \$288,782          | \$337,604        | \$597,939        | \$686,995        |   |
| Cost of revenue   | 211,126            | 240,418          | 432,003          | 491,884          |   |
| Gross profit  | 77,656             | 97,186           | 165,936          | 195,111          |   |
| Operating expenses:   |                    |                  |                  |                  |   |
| Research and development                                      | 21,102             | 22,476           | 41,554           | 44,657           |   |
| Sales and marketing   | 34,013             | 38,179           | 71,615           | 78,090           |   |
| General and administrative                                    | 10,366             | 11,894           | 21,389           | 23,269           |   |
| Restructuring and other charges                               | 974                | (12              | ) 5,368          | 830              |   |
| Litigation reserves, net                                      | —                  | 68               | (2,690           | ) 185            |   |
| Total operating expenses                                      | 66,455             | 72,605           | 137,236          | 147,031          |   |
| Income from operations  | 11,201             | 24,581           | 28,700           | 48,080           |   |
| Interest income   | 67                 | 49               | 119              | 106              |   |
| Other income (expense), net                                   | (343               | ) (227           | ) 132            | (335             | ) |
| Income before income taxes                                    | 10,925             | 24,403           | 28,951           | 47,851           |   |
| Provision for income taxes                                    | 7,258              | 9,698            | 17,273           | 18,735           |   |
| Net income  | \$3,667            | \$14,705         | \$11,678         | \$29,116         |   |
| Net income per share:   |                    |                  |                  |                  |   |
| Basic   | \$0.11             | \$0.41           | \$0.34           | \$0.80           |   |
| Diluted   | \$0.11             | \$0.40           | \$0.34           | \$0.79           |   |
| Weighted average shares used to compute net income per share: |                    |                  |                  |                  |   |
| Basic   | 33,792             | 36,139           | 34,227           | 36,381           |   |
| Diluted   | 34,308             | 36,808           | 34,790           | 37,052           |   |

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

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NETGEAR, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 28,<br>2015   | June 29,<br>2014 | June 28,<br>2015 | June 29,<br>2014 |
| Net income   | \$3,667            | \$14,705         | \$11,678         | \$29,116         |
| Other comprehensive income (loss), before tax:             |                    |                  |                  |                  |
| Unrealized gain (loss) on derivative instruments           | (88                | ) 132            | (112             | ) (73            |
| Unrealized gain on available-for-sale securities           | 18                 | 16               | 28               | 23               |
| Other comprehensive income (loss), before tax              | (70                | ) 148            | (84              | ) (50            |
| Tax expense related to items of other comprehensive income | (7                 | ) (6             | ) (11            | ) (9             |
| Other comprehensive income (loss), net of tax              | (77                | ) 142            | (95              | ) (59            |
| Comprehensive income                                       | \$3,590            | \$14,847         | \$11,583         | \$29,057         |

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

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NETGEAR, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 28,<br>2015 | June 29,<br>2014 |
| Cash flows from operating activities:   |                  |                  |
| Net income  | \$11,678         | \$29,116         |
| Adjustments to reconcile net income to net cash provided by operating activities:                           |                  |                  |
| Depreciation and amortization   | 18,692           | 17,399           |
| Purchase premium amortization/discount accretion on investments, net  | (58              | ) 69             |
| Non-cash stock-based compensation   | 8,406            | 10,064           |
| Income tax impact associated with stock option exercises  | (799             | ) (302           |
| Excess tax benefit from stock-based compensation  | (240             | ) (294           |
| Deferred income taxes   | 2,220            | (244             |
| Changes in assets and liabilities:  |                  |                  |
| Accounts receivable   | 29,196           | (16,416          |
| Inventories   | 34,215           | 29,924           |
| Prepaid expenses and other assets   | 6,428            | (10,972          |
| Accounts payable  | (34,508          | ) (13,128        |
| Accrued employee compensation   | (2,999           | ) 3,133          |
| Other accrued liabilities   | (20,912          | ) (13,767        |
| Deferred revenue  | (3,209           | ) 8,795          |
| Income taxes payable  | (9,603           | ) (661           |
| Net cash provided by operating activities   | 38,507           | 42,716           |
| Cash flows from investing activities:   |                  |                  |
| Purchases of short-term investments   | (25,105          | ) (84,936        |
| Proceeds from sales and maturities of short-term investments  | 65,142           | 94,500           |
| Purchase of property and equipment  | (8,200           | ) (9,418         |
| Payments made in connection with business acquisitions  | —                | (1,050           |
| Net cash provided by (used in) investing activities   | 31,837           | (904             |
| Cash flows from financing activities:   |                  |                  |
| Purchase and retirement of common stock   | (81,036          | ) (44,622        |
| Proceeds from exercise of stock options   | 4,471            | 5,161            |
| Proceeds from issuance of common stock under employee stock purchase plan                                   | 1,502            | 1,328            |
| Excess tax benefit from stock-based compensation  | 240              | 294              |
| Net cash used in financing activities   | (74,823          | ) (37,839        |
| Net increase (decrease) in cash and cash equivalents  | (4,479           | ) 3,973          |
| Cash and cash equivalents, at beginning of period   | 141,234          | 143,009          |
| Cash and cash equivalents, at end of period   | \$136,755        | \$146,982        |
| The accompanying notes are an integral part of these unaudited condensed consolidated financial statements. |                  |                  |

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NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Basis of Presentation

NETGEAR, Inc. ("NETGEAR" or the "Company") was incorporated in Delaware in January 1996. The Company is a global networking company that delivers innovative products to consumers, businesses and service providers. The Company's products are built on a variety of proven technologies such as wireless, Ethernet and powerline, with a focus on reliability and ease-of-use. The product line consists of wired and wireless devices that enable networking, broadband access and network connectivity. These products are available in multiple configurations to address the needs of the end-users in each geographic region in which the Company's products are sold.

The accompanying unaudited condensed consolidated financial statements include the accounts of NETGEAR, Inc. and its wholly owned subsidiaries. They have been prepared in accordance with established guidelines for interim financial reporting and with the instructions of Form 10-Q and Article 10 of Regulation S-X. All significant intercompany balances and transactions have been eliminated in consolidation. The balance sheet dated December 31, 2014 has been derived from audited financial statements at such date. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes typically found in the audited consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments considered necessary (consisting only of normal recurring adjustments) to fairly state the Company's financial position, results of operations, comprehensive income and cash flows for the periods indicated. These unaudited condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities, (ii) the disclosure of contingent assets and liabilities at the date of the financial statements, and (iii) the reported amounts of net revenue and expenses during the reported period. Actual results could differ materially from those estimates and operating results for the three and six months ended June 28, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or any future period.

Note 2. Summary of Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. The Company's significant accounting policies have not materially changed during the six months ended June 28, 2015.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customer" (Topic 606). The guidance in this update supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. An entity should apply the amendments in the update either retrospectively to each prior reporting period presented or

retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. On July 9, 2015, the FASB concluded to delay the effective date of the new revenue standard by one year. ASU 2014-09 is effective for the Company beginning in the first quarter fiscal 2018. Early adoption is permitted but may not occur earlier than January 1, 2017, the original effective date of the standard for the Company. The Company is in the process of evaluating the available transition methods and the impact of this standard on its financial position, results of operations or cash flows.



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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Note 3. Balance Sheet Components

## Available-for-sale short-term investments (in thousands)

|                            | As of<br>June 28, 2015 |                    |                    |                         | December 31, 2014 |                    |                    |                         |
|----------------------------|------------------------|--------------------|--------------------|-------------------------|-------------------|--------------------|--------------------|-------------------------|
|                            | Cost                   | Unrealized<br>Gain | Unrealized<br>Loss | Estimated<br>Fair Value | Cost              | Unrealized<br>Gain | Unrealized<br>Loss | Estimated<br>Fair Value |
| U.S. treasuries            | \$74,972               | \$19               | \$—                | \$74,991                | \$114,944         | \$6                | \$(15 )            | \$114,935               |
| Certificates of<br>deposit | 151                    | —                  | —                  | 151                     | 158               | —                  | —                  | 158                     |
| Total                      | \$75,123               | \$19               | \$—                | \$75,142                | \$115,102         | \$6                | \$(15 )            | \$115,093               |

The Company's short-term investments are primarily comprised of marketable securities that are classified as available-for-sale and consist of government securities with an original maturity or remaining maturity at the time of purchase of greater than three months and no more than 12 months. Accordingly, none of the available-for-sale securities have unrealized losses greater than 12 months.

## Accounts receivable, net (in thousands)

|                                 | As of            |                      |
|---------------------------------|------------------|----------------------|
|                                 | June 28,<br>2015 | December 31,<br>2014 |
| Gross accounts receivable       | \$263,877        | \$296,239            |
| Allowance for doubtful accounts | (1,255 )         | (1,255 )             |
| Allowance for sales returns     | (13,704 )        | (17,489 )            |
| Allowance for price protection  | (2,425 )         | (1,806 )             |
| Total allowances                | (17,384 )        | (20,550 )            |
| Total accounts receivable, net  | \$246,493        | \$275,689            |

## Inventories (in thousands)

|                   | As of            |                      |
|-------------------|------------------|----------------------|
|                   | June 28,<br>2015 | December 31,<br>2014 |
| Raw materials     | \$3,338          | \$3,625              |
| Work in process   | —                | 8                    |
| Finished goods    | 185,330          | 219,250              |
| Total inventories | \$188,668        | \$222,883            |

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

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NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Property and equipment, net (in thousands)

|  | As of            |                      |
|--|------------------|----------------------|
|  | June 28,<br>2015 | December 31,<br>2014 |
| Computer equipment                             | \$10,002         | \$9,779              |
| Furniture, fixtures and leasehold improvements | 17,984           | 19,379               |
| Software                                       | 29,908           | 29,294               |
| Machinery and equipment                        | 63,391           | 60,135               |
| Total property and equipment, gross            | 121,285          | 118,587              |
| Accumulated depreciation and amortization      | (95,694          | ) (88,893            |
| Total property and equipment, net              | \$25,591         | \$29,694             |

Depreciation and amortization expense pertaining to property and equipment was \$4.6 million and \$9.4 million for the three and six months ended June 28, 2015, respectively, and \$4.2 million and \$8.5 million for the three and six months ended June 29, 2014, respectively.

Intangibles, net (in thousands)

|                                      | Gross     | Accumulated<br>Amortization | Net        |
|--------------------------------------|-----------|-----------------------------|------------|
| June 28, 2015                        |           |                             |            |
| Technology                           | \$61,099  | \$(44,067                   | ) \$17,032 |
| Customer contracts and relationships | 56,500    | (19,748                     | ) 36,752   |
| Other                                | 10,545    | (6,895                      | ) 3,650    |
| Total intangibles, net               | \$128,144 | \$(70,710                   | ) \$57,434 |
| December 31, 2014                    |           |                             |            |
| Technology                           | \$61,099  | \$(39,341                   | ) \$21,758 |
| Customer contracts and relationships | 56,500    | (16,205                     | ) 40,295   |
| Other                                | 10,545    | (6,368                      | ) 4,177    |
| Total intangibles, net               | \$128,144 | \$(61,914                   | ) \$66,230 |

Amortization of intangibles was \$4.3 million and \$8.8 million for the three and six months ended June 28, 2015, respectively, and \$4.4 million and \$8.9 million for the three and six months ended June 29, 2014, respectively.

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NETGEAR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

| Year Ending December 31              | Amount   |
|--------------------------------------|----------|
| 2015 (remaining six months)          | \$8,487  |
| 2016                                 | 16,921   |
| 2017                                 | 11,386   |
| 2018                                 | 7,871    |
| 2019                                 | 6,028    |
| Thereafter                           | 6,741    |
| Total estimated amortization expense | \$57,434 |

Other non-current assets (in thousands)

|                                   | As of            |                      |
|-----------------------------------|------------------|----------------------|
|                                   | June 28,<br>2015 | December 31,<br>2014 |
| Non-current deferred income taxes | \$39,396         | \$38,696             |
| Cost method investment            | 1,322            | 1,322                |
| Other                             | 7,634            | 8,059                |
| Total other non-current assets    | \$48,352         | \$48,077             |

Other accrued liabilities (in thousands)

|                                 | As of            |                      |
|---------------------------------|------------------|----------------------|
|                                 | June 28,<br>2015 | December 31,<br>2014 |
| Sales and marketing programs    | \$44,689         | \$54,582             |
| Warranty obligation             | 40,967           | 44,888               |
| Freight                         | 4,490            | 6,827                |
| Other                           | 33,701           | 37,445               |
| Total other accrued liabilities | \$123,847        | \$143,742            |

#### Note 4. Derivative Financial Instruments

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

The Company's foreign currency forward contracts do not contain any credit-risk-related contingent features. The Company is exposed to credit losses in the event of nonperformance by the counter-parties of its forward contracts. The Company enters into derivative contracts with high-quality financial institutions and limits the amount of credit exposure to any one counter-party. In addition, the derivative contracts typically mature in less than six months and

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

The Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including, but not limited to, materiality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no

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NETGEAR, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign exchange rates. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with the authoritative guidance for derivatives and hedging. The Company records all derivatives on the balance sheet at fair value. The effective portions of cash flow hedges are recorded in other comprehensive income ("OCI") until the hedged item is recognized in earnings. Derivatives that are not designated as hedging instruments and the ineffective portions of its designated hedges are adjusted to fair value through earnings in other income (expense), net in the unaudited condensed consolidated statement of operations.

The fair values of the Company's derivative instruments and the line items on the unaudited condensed consolidated balance sheets to which they were recorded as of June 28, 2015 and December 31, 2014 are summarized as follows (in thousands):

| Derivative Assets  | Balance Sheet Location                    | Fair Value at June 28, 2015 | Balance Sheet Location                    | Fair Value at December 31, 2014 |
|--|---|-----------------------------|---|---------------------------------|
| Derivative assets not designated as hedging instruments      | Prepaid expenses and other current assets | \$439                       | Prepaid expenses and other current assets | \$2,416                         |
| Derivative assets designated as hedging instruments          | Prepaid expenses and other current assets | 70                          | Prepaid expenses and other current assets | —                               |
| Total  |   | \$509                       |   | \$2,416                         |
| Derivative Liabilities                                       | Balance Sheet Location                    | Fair Value at June 28, 2015 | Balance Sheet Location                    | Fair Value at December 31, 2014 |
| Derivative liabilities not designated as hedging instruments | Other accrued liabilities                 | \$2,142                     | Other accrued liabilities                 | \$409                           |
| Derivative liabilities designated as hedging instruments     | Other accrued liabilities                 | 71                          | Other accrued liabilities                 | 38                              |
| Total  |   | \$2,213                     |   | \$447                           |

For details of the Company's fair value measurements, see Note 11, Fair Value Measurements.

## Offsetting Derivative Assets and Liabilities

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

The following tables set forth the offsetting of derivative assets as of June 28, 2015 and December 31, 2014 (in thousands):

| As of June 28, 2015 | Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets | Net Amount |
|---------------------|---|------------|
|                     |   |            |

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|             | Gross<br>Amounts of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance Sheets | Net Amounts Of<br>Assets<br>Presented in the<br>Condensed<br>Consolidated<br>Balance Sheets | Financial<br>Instruments | Cash<br>Collateral<br>Pledged |     |
|-------------|---|--|---|--------------------------|-------------------------------|-----|
| Barclays    | \$97  | \$—  | \$97  | \$(97                    | ) \$—                         | \$— |
| Wells Fargo | 412   | —  | 412   | (412                     | ) —                           | —   |
| Total       | \$509                                       | \$—  | \$509   | \$(509                   | ) \$—                         | \$— |

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NETGEAR, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

| As of December<br>31, 2014 | Gross<br>Amounts of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance Sheets | Net Amounts Of<br>Assets<br>Presented in the<br>Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in<br>the Condensed Consolidated<br>Balance Sheets |                               | Net Amount |
|----------------------------|---|--|---|---|-------------------------------|------------|
|                            |   |  |   | Financial<br>Instruments  | Cash<br>Collateral<br>Pledged |            |
| Barclays                   | \$319                                       | \$—  | \$319   | \$(16   | ) \$—                         | \$303      |
| Wells Fargo                | 2,097                                       | —  | 2,097   | (431  | ) —                           | 1,666      |
| Total                      | \$2,416                                     | \$—  | \$2,416   | \$(447  | ) \$—                         | \$1,969    |

The following tables set forth the offsetting of derivative liabilities as of June 28, 2015 and December 31, 2014 (in thousands):

| As of June 28,<br>2015 | Gross<br>Amounts of<br>Recognized<br>Liabilities | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance Sheets | Net Amounts Of<br>Liabilities<br>Presented in the<br>Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in<br>the Condensed Consolidated<br>Balance Sheets |                               | Net Amount |
|------------------------|--|--|--|---|-------------------------------|------------|
|                        |  |  |  | Financial<br>Instruments  | Cash<br>Collateral<br>Pledged |            |
| Barclays               | \$437  | \$—  | \$437  | \$(97   | ) \$—                         | \$340      |
| JP Morgan<br>Chase     | 349  | —  | 349  | —   | —                             | 349        |
| Wells Fargo            | 1,427  | —  | 1,427  | (412  | ) —                           | 1,015      |
| Total                  | \$2,213  | \$—  | \$2,213  | \$(509  | ) \$—                         | \$1,704    |

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

## Cash flow hedges

To help manage the exposure of operating margins to fluctuations in foreign currency exchange rates, the Company hedges a portion of its anticipated foreign currency revenue, costs of revenue and certain operating expenses. These

hedges are designated at the inception of the hedge relationship as cash flow hedges under the authoritative guidance for derivatives and hedging. Effectiveness is tested at least quarterly both prospectively and retrospectively using regression analysis to ensure that the hedge relationship has been effective and is likely to remain effective in the future. The Company typically hedges portions of its anticipated foreign currency exposure for three to five months. The Company enters into about five forward contracts per quarter with an average size of approximately \$7.0 million USD equivalent related to its cash flow hedging program.

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

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur within the designated hedge period or if not recognized within 60 days following the end of the hedge period. Deferred gains and losses in OCI with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses



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## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

related to the loss of hedge designation as there were no discontinued cash flow hedges during the three and six months ended June 28, 2015 and June 29, 2014.

The effects of the Company's derivative instruments on OCI and the unaudited condensed consolidated statement of operations for the three and six months ended June 28, 2015 and June 29, 2014 are summarized as follows (in thousands):

| Derivatives Designated as Hedging Instruments | Three Months Ended June 28, 2015                      |   |   |  |  |
|---|---|---|---|--|--|
|   | Gain (Loss) Recognized in OCI - Effective Portion (a) | Location of Gain (Loss) Reclassified from OCI into Income - Effective Portion | Gain (Loss) Reclassified from OCI into Income - Effective Portion (a) | Location of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing | Amount of Gain (Loss) Recognized in Income and Excluded from Effectiveness Testing |
| Cash flow hedges:                             |   |   |   |  |  |
| Foreign currency forward contracts            | \$(688 )  | Net revenue   | \$(775 )  | Other income (expense), net  | \$ (15 )   |
| Foreign currency forward contracts            | —   | Cost of revenue   | 5   | Other income (expense), net  | —  |
| Foreign currency forward contracts            | —   | Operating expenses  | 170   | Other income (expense), net  | —  |
| Total   | \$(688 )  |   | \$(600 )  |  | \$ (15 )   |

(a) Refer to Note 8, Stockholders' Equity, which summarizes the accumulated other comprehensive income activity related to derivatives.