NETGEAR, INC
Form 10-Q
May 11, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended April 1, 2007.

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

For the transition period from to

Commission file number: 000-50350

NETGEAR, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0419172**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
4500 Great America Parkway, Santa Clara, California	**95054**
(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 þ No o

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

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

The number of outstanding shares of the registrant s Common Stock, $0.001 par value, was 34,613,313 as of May 4, 2007.

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NETGEAR, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	April 1, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 105,585	$ 87,736
Short-term investments	110,637	109,729
Accounts receivable, net	123,301	119,601
Inventories	68,368	77,932
Deferred income taxes	13,443	13,415
Prepaid expenses and other current assets	16,722	15,946
Total current assets	438,056	424,359
Property and equipment, net	6,953	6,568
Intangibles, net	900	975
Goodwill	3,800	3,800
Other non-current assets	1,500	2,202
Total assets	$ 451,209	$ 437,904
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 32,804	$ 39,818
Accrued employee compensation	8,910	11,803
Other accrued liabilities	77,693	75,909
Deferred revenue	5,757	8,215
Income taxes payable	3,021	7,737
Total current liabilities	128,185	143,482
Non-current income taxes payable	4,923	
Total liabilities	133,108	143,482
Commitments and contingencies (Note 10)		
Stockholders equity:		
Common stock	34	33
Additional paid-in capital	230,893	221,487
Cumulative other comprehensive loss	(9)	(5)
Retained earnings	87,183	72,907
Total stockholders equity	318,101	294,422
Total liabilities and stockholders equity	$ 451,209	$ 437,904

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

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

	Three Months Ended	
	April 1, 2007	April 2, 2006
Net revenue	$ 173,572	$ 127,259
Cost of revenue (1)	113,542	82,711
Gross profit	60,030	44,548
Operating expenses:		
Research and development (1)	6,156	4,532
Sales and marketing (1)	27,826	20,682
General and administrative (1)	6,914	4,423
Total operating expenses	40,896	29,637
Income from operations	19,134	14,911
Interest income	2,371	1,602
Other income	272	69
Income before income taxes	21,777	16,582
Provision for income taxes	7,756	6,714
Net income	$ 14,021	$ 9,868
Net income per share:		
Basic	$ 0.41	$ 0.30
Diluted	$ 0.40	$ 0.29
Weighted average shares outstanding used to compute net income per share:		
Basic	34,308	33,045
Diluted	35,362	34,091

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

Cost of revenue	$ 133	$ 91
Research and development	469	201
Sales and marketing	622	293
General and administrative	623	240

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

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

	Three Months Ended April 1, 2007	Three Months Ended April 2, 2006
Cash flows from operating activities:		
Net income	$ 14,021	$ 9,868
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,298	780
Accretion of purchase discounts on investments	(394)	(368)
Non-cash stock-based compensation	1,847	825
Income tax benefit associated with stock option exercises	3,427	387
Excess tax benefit from stock-based compensation	(2,651)	(353)
Deferred income taxes	671	211
Changes in assets and liabilities:		
Accounts receivable	(3,700)	(1,783)
Inventories	9,564	6,989
Prepaid expenses and other current assets	(772)	(1,495)
Accounts payable	(7,014)	(7,529)
Accrued employee compensation	(2,893)	(2,273)
Other accrued liabilities	1,784	(6,875)
Deferred revenue	(2,458)	3,363
Income taxes payable	462	2,629
Net cash provided by operating activities	13,192	4,376
Cash flows from investing activities:		
Purchases of short-term investments	(24,118)	(45,190)
Proceeds from sale of short-term investments	23,600	26,000
Purchase of property and equipment	(1,608)	(1,614)
Net cash used in financing activities	(2,126)	(20,804)
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,505	378
Proceeds from issuance of common stock under employee stock purchase plan	627	518
Excess tax benefit from stock-based compensation	2,651	353
Net cash provided by financing activities	6,783	1,249
Net increase (decrease) in cash and cash equivalents	17,849	(15,179)
Cash and cash equivalents, at beginning of period	87,736	90,002
Cash and cash equivalents, at end of period	$ 105,585	$ 74,823

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 personal computers. 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, 2006 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, 2006.

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 months ended April 1, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The Company s significant accounting policies are disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. Other than the Company s accounting policy relating to income taxes presented below, the Company s significant accounting policies have not materially changed during the three months ended April 1, 2007.

Income Taxes

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

As discussed in Note 8, effective January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). In the ordinary course of business there is inherent uncertainty in assessing the Company s income tax positions. The Company assesses its tax positions and records benefits for all years subject to examination based on management s evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company records the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recorded in the financial statements. Where applicable, associated interest and penalties have also been recognized as a component of income tax expense.

2. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 also amends certain provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on the consolidated financial statements.

3. Stock-based Compensation

The Company grants options and restricted stock units from the 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 April 1, 2007, 1,346,851 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 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	
	April 1, 2007	**April 2, 2006**
Expected life (in years)	4.6	5.0
Risk-free interest rate	4.67%	4.50%
Expected volatility	55%	66%
Dividend yield		

As of April 1, 2007, $16.9 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 1.68 years. Additionally, $3.7 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 1.73 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 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):

	Three Months Ended	
	April 1, 2007	**April 2, 2006**
Balance as of beginning of the period	$ 21,299	$ 11,845
Provision for warranty liability made during the period	10,313	9,379
Settlements made during the period	(9,726)	(8,610)
Balance at end of period	$ 21,886	$ 12,614

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 $3.0 million for the three months ended April 1, 2007 and $2.1 million for the three months ended April 2, 2006.

6. Balance Sheet Components

Accounts receivable, net:

	April 1, 2007	December 31, 2006
	(In thousands)	
Gross accounts receivable	$ 136,212	$ 132,651
Less: Allowance for doubtful accounts	(1,882)	(1,727)
Allowance for sales returns	(8,356)	(8,129)
Allowance for price protection	(2,673)	(3,194)
Total allowances	(12,911)	(13,050)
Accounts receivable, net	$ 123,301	$ 119,601

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Inventories:

	April 1, 2007	December 31, 2006
	(In thousands)	
Finished goods	$ 68,368	$ 77,932

Other accrued liabilities:

	April 1, 2007	December 31, 2006
	(In thousands)	
Sales and marketing programs	$ 38,050	$ 38,058
Warranty obligation	21,886	21,299
Freight	4,084	4,073
Other	13,673	12,479
Other accrued liabilities	$ 77,693	$ 75,909

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.

Net income per share for the three months ended April 1, 2007 and April 2, 2006 are as follows (in thousands, except per share data):

	Three Months Ended	
	April 1, 2007	April 2, 2006
Net income	$ 14,021	$ 9,868
Weighted average shares outstanding:		
Basic	34,308	33,045
Dilutive potential common shares	1,054	1,046
Total diluted	35,362	34,091
Basic net income per share	$ 0.41	$ 0.30
Diluted net income per share	$ 0.40	$ 0.29

Weighted average stock options and unvested restricted stock awards to purchase 1,469,299 and 856,641 shares of the Company s stock for the three months ended April 1, 2007 and April 2, 2006, 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 35.6% and 40.5% for the quarters ended April 1, 2007 and April 2, 2006, respectively. The reduction in the effective tax rate was primarily caused by increases in earnings in jurisdictions with rates lower than the U.S. where the Company intends to permanently reinvest such earnings.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of adoption, the Company recognized a decrease in income tax liabilities of approximately $255,000 and a corresponding increase in retained earnings as of January 1, 2007. As of the adoption date, the Company had gross unrecognized tax benefits of $5.6 million and accrued interest expense of $294,000. The total amount of tax and accrued interest as of January 1, 2007, that, if recognized, would affect the effective tax rate was $2.6 million and $177,000, respectively. Consistent with the provisions of FIN 48, the Company reclassified $5.9 million of current income tax liabilities resulting in a $4.9 million increase to non-current income taxes payable and $1.0 million decrease to non-current deferred tax assets. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense.

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 2000. The Company is under examination in the state of California for 2002 through 2004. The Company expects the examination will conclude in 2007. At this time the Company cannot estimate the possible change in unrecognized tax benefits.

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 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 the United States. 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 geography based on the geographic location of the customer. Net revenue by geography comprises gross revenue less such items as end-user customer rebates and other sales incentives deemed to be a reduction of net revenue per Emerging Issues Task Force (EITF) Issue No. 01-9, sales returns and price protection, which reduce gross revenue.

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

	Three Months Ended	
	April 1, 2007	**April 2, 2006**
United States	$ 66,059	$ 56,382
United Kingdom	46,254	20,156
Germany	14,515	15,179
EMEA (excluding UK and Germany)	31,783	21,453
Asia Pacific and rest of the world	14,961	14,089
	$ 173,572	$ 127,259

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):

	April 1, 2007	**December 31, 2006**
United States	$ 5,532	$ 4,878
EMEA	562	592
Asia Pacific and rest of the world	859	1,098
	$ 6,953	$ 6,568

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

	Three Months Ended	
	April 1, 2007	**April 2, 2006**

Ingram Micro, Inc.	18%	24%
Tech Data Corporation	15%	17%
All others individually less than 10% of net revenue	67%	59%
	100%	100%

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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, United States Court of Appeals for the Federal Circuit affirmed the District Court s decision to deny CSIRO s motion to dismiss the action under the Foreign Sovereign Immunities Act. In September 2006, the Federal Circuit denied CSIRO s request for a rehearing en banc. CSIRO filed a response to the complaint in September 2006. In December 2006, the District Court granted CSIRO s motion to transfer the case to the Eastern District of Texas, where CSIRO had brought a similar lawsuit against Buffalo Technology (USA), Inc. This action is in the discovery phase.

SercoNet v. NETGEAR

In May 2006, a lawsuit was filed against the Company by SercoNet, Ltd., a manufacturer of computer networking products organized under the laws of Israel, in the United States District Court for the Southern District of New York. SercoNet alleges that the Company infringes U.S. Patents Nos. 5,841,360; 6,480,510; 6,970,538; 7,016,368; and 7,035,280. SercoNet has accused certain of the Company s switches, routers, modems, adapters, powerline products, and wireless access points of infringement. In July 2006, the court granted the Company s motion to transfer the action to the Northern District of California. This action is in the discovery phase.

These 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.

While the outcome of these matters is currently not determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

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 FASB Staff Position (FSP) SFAS 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 months ended April 1, 2007 and the three months ended April 2, 2006. 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.

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), and 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 April 1, 2007, the Company had $68.7 million in non-cancelable purchase commitments with suppliers. The Company expects to sell all products for which it has committed purchases from suppliers.

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 April 1, 2007.

In its sales agreements, the Company typically agrees to indemnify its 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. To date the Company has not paid any amounts to settle claims or defend lawsuits. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of April 1, 2007.

11. Subsequent Events

On May 2, 2007, the Company entered into a definitive agreement to acquire Infrant Technologies, Inc. (Infrant). Infrant designs and sells network attached storage (NAS) products and technologies, including the ReadyNAS(TM) product family, for small business, professional and home customers. Under the terms of the agreement , the Company will pay $60 million in cash for Infrant. Infrant shareholders may receive a total additional payout of up to $20 million in cash over the three years following closure of the acquisition if specific net revenue targets are reached.

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 its 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,

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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 personal computers, or PCs, 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, or DMRs, value added resellers, or VARs, and broadband service providers. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, Circuit City, CompUSA, Costco, Fry s Electronics, Radio Shack, Staples, 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 36.4% from the three months ended April 2, 2006 to the three months ended April 1, 2007. The increase in net revenue was especially attributable to increased shipments in our broadband gateway and small business switch product categories. This growth was most notably driven by increased sales of broadband gateways to service providers, especially in the United Kingdom, with additional strength in the United States. We have also experienced growth across all switch product categories, most notably our managed switch and smart switch 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 34.6% for the three months ended April 1, 2007, from 35.0% for the three months ended April 2, 2006. This decrease was due primarily to increased sales of products carrying lower gross margins to service providers, and to a lesser extent, increased warranty costs. Operating expenses for the three months ended April 1, 2007 were $40.9 million, or 23.6% of net revenue, compared to $29.6 million, or 23.3% of net revenue, for the three months ended April 2, 2006.

Net income increased $4.1 million, or 42.1%, to $14.0 million for the three months ended April 1, 2007, from $9.9 million for the three months ended April 2, 2006. This increase was primarily due to an increase in gross profit of $15.5 million and an increase in interest income of $769,000, partially offset by an increase in operating expenses of $11.3 million and an increase in the provision for income taxes of $1.1 million.

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Results of Operations

The following table sets forth the consolidated statements of operations and the percentage change for the three months ended April 1, 2007, with the comparable reporting period in the preceding year.

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
Net revenue	$ 173,572	36.4%	$ 127,259
Cost of revenue	113,542	37.3	82,711
Gross profit	60,030	34.8	44,548
Operating expenses:			
Research and development	6,156	35.8	4,532
Sales and marketing	27,826	34.5	20,682
General and administrative	6,914	56.3	4,423
Total operating expenses	40,896	38.0	29,637
Income from operations	19,134	28.3	14,911
Interest income	2,371	48.0	1,602
Other income	272	294.2	69
Income before income taxes	21,777	31.3	16,582
Provision for income taxes	7,756	15.5	6,714
Net income	$ 14,021	42.1%	$ 9,868

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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	
	April 1, 2007	April 2, 2006
Net revenue	100%	100%
Cost of revenue	65.4	65.0
Gross margin	34.6	35.0
Operating expenses:		
Research and development	3.6	3.6
Sales and marketing	16.0	16.2
General and administrative	4.0	3.5
Total operating expenses	23.6	23.3
Income from operations	11.0	11.7
Interest income	1.4	1.3
Other income	0.1	0.0
Income before income taxes	12.5	13.0
Provision for income taxes	4.4	5.2
Net income	8.1%	7.8%

Three Months Ended April 1, 2007 Compared to Three Months Ended April 2, 2006
Net Revenue

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
Net revenue	$173,572	36.4%	$127,259

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 $46.3 million, or 36.4%, to $173.6 million for the three months ended April 1, 2007, from $127.3 million for the three months ended April 2, 2006. The increase in net revenue was especially attributable to increased shipments in our broadband gateway and small business switch product categories. This growth was most notably driven by increased sales of broadband gateways to service providers, especially in the United Kingdom, with additional strength in the United States. We have also experienced growth across all switch product categories, most notably our managed switch and smart switch products.

Marketing expenses that are classified as contra-revenue grew at a slower rate than overall gross sales, which further contributed to the increased net revenue. This is primarily due to increased sales to service providers and increased sales in our small business product categories, which typically entails less marketing spending.

In the three months ended April 1, 2007, net revenue generated within North America, Europe, Middle-East and Africa (EMEA) and Asia Pacific was 38.1%, 53.3% and 8.6%, respectively, of our total net revenue. The comparable net revenue for the three months ended April 2, 2006 was 44.3%, 44.6% and 11.1%, respectively, of our total net revenue. The increase in net revenue over the prior year comparable quarter for each region was 17.2%, 63.0% and 6.2%, respectively. The EMEA increase in net revenue was primarily attributable to growth in the United Kingdom, as a result of increased sales of wireless broadband internet gateways to service providers. Continued success in partnering with EMEA retailers and ongoing promotional efforts also boosted our sales of home gateways, especially in Central Europe and Italy.

Cost of Revenue and Gross Margin

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
Cost of revenue	$113,542	37.3%	$82,711
Gross margin percentage	34.6%		35.0%

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; freight; and warranty costs associated with returned goods and write-downs for excess and obsolete inventory. We outsource our manufacturing, warehousing and distribution logistics. We believe this outsourcing strategy allows us to better manage our product costs and gross margin. Our gross margin can be affected by a number of factors, including 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 $30.8 million, or 37.3%, to $113.5 million for the three months ended April 1, 2007, from $82.7 million for the three months ended April 2, 2006. In addition, our gross margin decreased to 34.6% for the three months ended April 1, 2007, from 35.0% for the three months ended April 2, 2006. Our growth in net revenue came primarily from increased sales of products carrying lower gross margins to service providers, thereby bringing our overall gross margin down. We also incurred higher warranty costs associated with end user warranty returns. This decrease was partially mitigated by certain gross margin improvements. Sales incentives, recorded as a reduction to net revenue, grew at a relatively slower rate than overall gross revenue, resulting in a margin benefit. Additionally, we experienced relatively lower freight costs, as we were able to shift the mix of inbound shipments from our suppliers from more costly air freight to lower cost sea freight.

Operating Expenses

Research and Development

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
Research and development expense	$6,156	35.8%	$4,532
Percentage of net revenue	3.6%		3.6%

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, enhance the ease-of-use of our products, and broaden our core competencies.

Research and development expenses increased $1.7 million, or 35.8%, to $6.2 million for the three months ended April 1, 2007, from $4.5 million for the three months ended April 2, 2006. The increase was primarily due to higher salary, related payroll, and other employee expenses of $1.2 million resulting from research and development related headcount growth, including $292,000 related to retention bonuses for certain employees associated with the acquisition of SkipJam Corp. (SkipJam). Employee headcount increased by 25% to 69 employees as of April 1, 2007 as compared to 55 employees as of April 2, 2006, partially due to employees obtained from the acquisition of SkipJam. Additionally, stock-based compensation expense increased $268,000 to $469,000 for the three months ended April 1, 2007, from $201,000 for the three months ended April 2, 2006.

Sales and Marketing

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
Sales and marketing expense	$27,826	34.5%	$20,682
Percentage of net revenue	16.0%		16.2%

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 planned growth of our business.

Sales and marketing expenses increased $7.1 million, or 34.5%, to $27.8 million for the three months ended April 1, 2007, from $20.7 million for the three months ended April 2, 2006. Of this increase, $3.1 million was due to increased salary and payroll related expenses as a result of sales and marketing related headcount growth. Employee headcount increased by 34% to 221 employees as of April 1, 2007, compared to 165 employees as of April 2, 2006. More specifically, 44 of the 56 incremental employees relate to expansion in EMEA and Asia Pacific. We have continued to expand our geographic market presence with investments in sales resources, and incurred a $1.2 million increase in advertising, travel, and promotion expenses related to expanded marketing activities. Outbound freight increased $949,000, reflecting our higher sales volume. Outside service fees related to customer service and technical support also increased by $838,000, in support of higher call volumes related to increased units sold and geographic expansion. Furthermore, IT infrastructure costs allocated to sales and marketing increased $504,000 as a result of additional investments in software and systems in 2007. Additionally, stock-based compensation expense increased $329,000 to $622,000 for the three months ended April 1, 2007, from $293,000 for the three months ended April 2, 2006.

General and Administrative

	Three Months Ended		
	April 1, 2007	Percentage Change	April 2, 2006
	(In thousands, except percentage data)		
General and administrative expense	$6,914	56.3%	$4,423
Percentage of net revenue	4.0%		3.5%

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 $2.5 million, or 56.3%, to $6.9 million for the three months ended April 1, 2007, from $4.4 million for the three months ended April 2, 2006. The increase was due to higher salary and payroll related expenses of $903,000 due to an increase in general and administrative related headcount and increases in compensation for existing employees. Employee headcount increased by 14% to 65 employees as of April 1, 2007 compared to 57 employees as of April 2, 2006. We also incurred a $1.1 million increase in fees for outside professional services related to tax and legal consulting. Additionally, stock-based compensation expense increased

$383,000 to $623,000 for the three months ended April 1, 2007, from $240,000 for the three months ended April 2, 2006.

Interest Income and Other Income

	Three Months Ended April 1, 2007	April 2, 2006
	(In thousands)	
Interest income and other income		
Interest income	$ 2,371	$ 1,602
Other income	272	69
Total interest income and other income	$ 2,643	$ 1,671

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

Interest income increased $769,000, or 48.0%, to $2.4 million for the three months ended April 1, 2007, from $1.6 million for the three months ended April 2, 2006. The increase in interest income was due to an increase in cash, cash equivalents and short-term investments and an increase in the average interest rate earned in the first quarter of 2007 as compared to the first quarter of 2006.

Other income increased $203,000 to $272,000 for the three months ended April 1, 2007, from $69,000 for the three months ended April 2, 2006. The income was primarily attributable to foreign exchange gains experienced due to the weakening of the U.S. dollar against the euro and British pound in the first quarter of 2006, and weakening of the U.S. dollar against the euro and Australian dollar in the first quarter of 2007.

Provision for Income Taxes

The provision for income taxes increased $1.1 million, to $7.8 million for the three months ended April 1, 2007, from $6.7 million for the three months ended April 2, 2006. The effective tax rate was approximately 35.6% for the three months ended April 1, 2007 and approximately 40.5% for the three months ended April 2, 2006. The reduction in the effective tax rate for the quarter ended April 1, 2007 compared to the quarter ended April 2, 2006 is primarily caused by increases in earnings in jurisdictions with tax rates lower than the U.S. where we intend to indefinitely reinvest such earnings.

As described in Note 1 and Note 8 of the Notes to Unaudited Condensed Consolidated Financial Statements, we have adopted FIN 48 as of January 1, 2007.

Net Income

Net income increased $4.1 million, or 42.1%, to $14.0 million for the three months ended April 1, 2007, from $9.9 million for the three months ended April 2, 2006. This increase was primarily due to an increase in gross profit of $15.5 million and an increase in interest income of $769,000, partially offset by an increase in operating expenses of $11.3 million and an increase in the provision for income taxes of $1.1 million.

Liquidity and Capital Resources

As of April 1, 2007, we had cash, cash equivalents and short-term investments totaling $216.2 million. Short-term investments accounted for $110.6 million of this balance.

Our cash and cash equivalents balance increased from $87.7 million as of December 31, 2006 to $105.6 million as of April 1, 2007. Operating activities during the three months ended April 1, 2007 provided cash of $13.2 million. Investing activities during the three months ended April 1, 2007 used $2.1 million for the net purchase of short-term investments of $518,000 and purchases of property and equipment amounting to $1.6 million. During the three months ended April 1, 2007, financing activities provided $6.8 million, resulting 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 66 days as of December 31, 2006 to 65 days as of April 1, 2007.

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Our accounts payable decreased from $39.8 million at December 31, 2006 to $32.8 million at April 1, 2007. The decrease of $7.0 million is primarily due to relative timing of payments.

Inventory decreased by $9.5 million from $77.9 million at December 31, 2006 to $68.4 million at April 1, 2007. In the quarter ended April 1, 2007 we experienced annual ending inventory turns of approximately 6.6, up from approximately 5.7 in the quarter ended December 31, 2006.

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 April 1, 2007, we had approximately $68.7 million in non-cancelable purchase commitments with suppliers. We expect to sell all products for which we have committed purchases from suppliers.

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 April 1, 2007 (in thousands):

Contractual Obligations	Less than 1 Year	1 - 3 Years	3 - 5 Years	Over 5 Years	Total
Operating leases	$ 2,859	$ 3,093	$ 1,158	$ 2,910	$ 10,020
Purchase obligations	68,680				68,680
	$ 71,539	$ 3,093	$ 1,158	$ 2,910	$ 78,700

As of April 1, 2007, 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.

Effective January 1, 2007, we adopted the provisions of FIN 48 (see Note 8 of the Notes to Unaudited Condensed Consolidated Financial Statements). As of April 1, 2007, the liability for uncertain tax positions, net of federal impacts on tax issues, is $5.1 million. None is expected to be paid within one year, nor can we make a reliable estimate when cash settlement with a taxing authority may occur.

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, 2006. Other than our accounting policy relating to income taxes presented in Note 1 of the Notes to Unautied Condensed Consolidated Financial Statements, our critical accounting policies have not materially changed during the three months ended April 1, 2007.

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

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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 April 1, 2007, 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 $2.8 million to net income at April 1, 2007.

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 accounting 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 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 accounting 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 Securities Exchange Act of 1934 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. We are aware that any system of controls, however well designed and operated, can only provide reasonable, and not absolute, assurance that the objectives of the system are met, and that maintenance of disclosure controls and procedures is an ongoing process that may change over time.

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 Form 10-Q 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;

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- 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;
- 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 which 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 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 in local currency;
- bad debt exposure as we expand into new international markets; and
- changes in accounting rules, such as recording expenses for employee stock option grants.

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 this 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 advertising expenditures or other 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 Corporation, Allied Telesyn International, Dell Computer Corporation, D-Link Systems, Inc., Hewlett-Packard Company, the Linksys division of Cisco Systems and Nortel Networks. Our principal competitors in the home market include Belkin Corporation, D-Link and the Linksys division of Cisco Systems. Our principal competitors in the broadband service provider market include ARRIS International, Inc., Motorola, Inc., Sagem Corporation, Scientific Atlanta, a Cisco company, ZyXEL Communications Corp.., Thomson Corporation and 2Wire, Inc. Other current and potential competitors include numerous local vendors such as Siemens Corporation and AVM in Europe, Corega International SA, Melco, Inc./Buffalo Technology 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.

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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 the sales channel 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 channel, 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.

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 or lose sales or have to ship products by air freight to meet immediate demand incurring incremental freight costs above the costs of transporting product via boat, 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 or members of our sales channel, 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. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

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.

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 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 channel, 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 channel, and our failure to maintain and expand our sales channel 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 channel. We sell our products through our sales channel, 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. If we were unable to maintain and expand our sales channel, 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 face a number of challenges associated with penetrating 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 customer service and support demands, 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 wildly 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. 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.

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. 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 successful product liability or other claim could result in negative publicity and harm our reputation, result in unexpected expenses and adversely impact our operating results.

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 contract manufacturers 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.

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 Western Europe, and turmoil in the international geopolitical environment may adversely affect our operating results.

We derive a significant percentage of our revenues from international sales, and a deterioration in global economic and market conditions, particularly in Western Europe, may result in reduced product demand, increased price competition and higher excess inventory levels. Turmoil in the global geopolitical environment, including the ongoing tensions in Iraq and the Middle-East, have pressured and continue 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.

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. 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.

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 April 1, 2007, sales to Ingram Micro and its affiliates accounted for 18% of our net revenue and sales to Tech Data and its affiliates accounted for 15% 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.

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. Such report must also contain a statement that our independent registered public accounting firm has issued an audit report on management s assessment of such internal controls.

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 attest that our management s report is fairly stated or they are 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 depend on a limited number of third-party contract manufacturers for substantially all of our manufacturing needs. If these contract 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, or ODMs, and original equipment manufacturers, or OEMs. We rely on our contract manufacturers to procure components and, in some cases, subcontract engineering work. Some of our products are manufactured by a single contract manufacturer. We do not have any long-term contracts with any of our third-party contract manufacturers. Some of these third-party contract manufacturers produce products for our competitors. The loss of the services of any of our primary third-party contract manufacturers could cause a significant disruption in operations and delays in product shipments. Qualifying a new contract manufacturer and commencing volume production is expensive and time consuming.

Our reliance on third-party contract 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 ODM and OEM contract manufacturers are primarily responsible for obtaining most regulatory approvals for our products. If our ODMs and OEMs fail to obtain timely domestic or foreign regulatory approvals or certificates, we would be unable to sell our products and our sales and profitability could be reduced, our relationships with our sales channel could be harmed, and our reputation and brand would suffer.

If we are unable to provide our third-party contract 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 contract 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 contract manufacturers may be unable to manufacture products in a timely manner. If our forecasts are too high, our contract 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 contract 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 over supply of higher-priced components. Moreover, if they are unable to use components ordered at our direction, we will need to reimburse them for any losses they incur.

We rely upon third parties for technology that is critical to our products, and if we are unable to continue to use this technology and future technology, our ability to develop, sell, maintain and support technologically 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 2006. 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, or WEEE directive in Europe, that may vary from country to country and that are costly to comply with; and
- difficulties and costs of staffing and managing foreign operations.

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.

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. As part of the reorganization, we have been implementing new information technology systems, including new forecasting and order processing systems. If we fail to successfully and timely integrate these new systems, we will suffer disruptions to our operations. Any unanticipated interruptions in our business operations as a result of implementing these changes could result in loss or delay in revenue causing an adverse effect on our financial results.