NETGEAR, INC
Form 10-K
March 04, 2009
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the fiscal year ended December 31, 2008

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

Commission file number 000-50350

NETGEAR, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0419172**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
350 East Plumeria Drive,	
San Jose, California	**95134**

(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code

(408) 907-8000

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

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.001	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of June 27, 2008 was approximately $378,612,000. Such aggregate market value was computed by reference to the closing price of the common stock as reported on the Nasdaq Global Select Market on June 27, 2008 (the last business day of the Registrant s most recently completed fiscal second quarter). Shares of common stock held by each executive officer and director and each entity that owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the registrant s Common Stock, $0.001 par value, was 34,376,650 shares as of February 17, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant s 2009 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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PART I

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

Item 1. *Business*

General

We design, develop and market networking products for home users and for small business, which we define as a business with fewer than 250 employees. We are focused on satisfying the ease-of-use, quality, reliability, performance and affordability requirements of these users. Our product offerings enable users to connect and communicate across local area networks, or LANs, and the World Wide Web and share Internet access, peripherals, files, digital multimedia content and applications among multiple networked devices and other Internet-enabled devices. We sell our products through multiple sales channels worldwide, which includes traditional retailers, online retailers, direct market resellers, or DMRs, value added resellers, or VARs, and broadband service providers. A discussion of factors potentially affecting our operations is set forth in Risk Factors in Part I, Item 1A of this Form 10-K.

We were incorporated in Delaware on January 8, 1996. Our principal executive offices are located at 350 East Plumeria Drive, San Jose, California 95134, and our telephone number at that location is (408) 907-8000. We file reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, in accordance with the Exchange Act. You may read and copy our reports, proxy statements and other information filed by us at the SEC s Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. Our filings are also available to the public over the Internet at the SEC s website at *http://www.sec.gov*, and, as soon as practicable after such reports are filed with the SEC, free of charge through a hyperlink on our Internet website at *http://www.netgear.com.* Information contained on these websites is not a part of this Form 10-K.

Markets

Our goal is to be the leading provider of innovative networking products to the small business and home markets. A number of factors are driving today s demand for networking products within small businesses and homes. As the number of computing devices, such as PCs, has increased in recent years, networks are being

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deployed in order to share information and resources among users and devices. This information and resource sharing occurs internally, through a local area network, or externally, via the Internet. To take advantage of complex applications, advanced communication capabilities and rich multimedia content, users are upgrading their Internet connections by deploying high-speed broadband access technologies. Users also seek the convenience and flexibility of operating their PCs, laptops and related computing devices and accessing their content in a more mobile, or wireless, manner. Finally, as the usage of networks, including the Internet, has increased, users have become much more focused on the security of their connections and the protection of the data within their networks.

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

Sales Channels

We sell our products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, DMRs, VARs, and broadband service providers.

Retailers. Our retail channel primarily supplies products that are sold into the home market. We sell directly to, or enter into consignment arrangements with, a number of our traditional retailers. The remaining traditional retailers, as well as our online retailers, are fulfilled through wholesale distributors, the largest of which are Ingram Micro, Inc. and Tech Data Corporation. We work directly with our retail channels on market development activities, such as co-advertising, in-store promotions and demonstrations, instant rebate programs, event sponsorship and sales associate training, as well as establishing store within a store websites and banner advertising.

DMRs and VARs. We primarily sell into the small business market through an extensive network of DMRs and VARs. Our DMRs include companies such as CDW and Insight. VARs include our network of registered Powershift Partners, or resellers who achieve prescribed quarterly sales goals and as a result may receive sales incentives, marketing support and other program benefits from us. Our products are also resold by a large number of smaller VARs whose sales are not large enough to qualify them for our Powershift Partner program. Our DMRs and VARs generally purchase our products through our wholesale distributors, primarily Ingram Micro and Tech Data.

Broadband Service Providers. We also supply our products directly to broadband service providers in the United States and internationally, who distribute our products to their small business and home subscribers.

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We derive the majority of our net revenue from international sales. International sales as a percentage of net revenue decreased from 62% in 2007 to 60% in 2008. The table below sets forth our net revenue by major geographic region.

	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
United States	$ 297,641	9%	$ 273,695	24%	$ 220,440
EMEA	354,058	(7)%	380,354	28%	298,234
Asia Pacific and rest of world	91,645	24%	73,738	34%	54,896
	$ 743,344	2%	$ 727,787	27%	$ 573,570

Net revenues from significant customers as a percentage of our total net revenues for the years ended December 31, 2008, 2007 and 2006 were as follows:

	Year Ended December 31, 2008	2007	2006
Ingram Micro, Inc.	14%	17%	19%
Tech Data Corporation	11%	14%	16%

Product Offerings

Our product line consists of wired and wireless devices that enable Ethernet networking, broadband access, network connectivity, network storage and security appliances. These products are available in multiple configurations to address the needs of our customers in each geographic region in which our products are sold.

Ethernet networking. Ethernet is the most commonly used wired network protocol for connecting devices in today s home and small-office networks. Products that enable Ethernet networking include:

switches, which are multiple port devices used to network PCs and peripherals;

network interface cards, adapters and bridges, that enable PCs and other equipment to be connected to a network;

Internet Security Appliances, which provide Internet access through capabilities such as anti-virus and anti-spam.

Broadband Access. Broadband is a transmission medium capable of moving more digital content over public high speed networks than traditional low speed telephone lines. Products that enable broadband access include:

routers, which connect the home or office networks to the Internet via broadband modems;

gateways, which are routers with integrated modems, for Internet access;

IP telephony products, used for transmitting voice communications over a network; and

- wireless gateways, or gateways that include an integrated wireless access point.

Network Connectivity. Products that enable network connectivity and resource sharing include:

- wireless access points, which provide a wireless link between a wired network and wireless devices;
- wireless network interface cards and adapters, which enable devices to be connected to the network wirelessly;
- media adapters, which connect non PC entertainment devices such as TVs, audio players, and game consoles to a network;

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- wi-fi phones, which enable users to make voice calls over the Internet;

- network attached storage, which enables file sharing among multiple PCs and media adapters over a local area network; and

- powerline adapters and bridges, which enable devices to be connected to the network over existing electrical wiring.

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

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

Our products for the home user are designed with pleasing visual and physical aesthetics that are more desirable in a home environment. For example, our RangeMax series of routers have distinctive blue antenna-indicator LEDs in a circular dome atop a sleek black or white plastic casing. Our connectivity offerings for use in the home are generally at a lower price than higher security and configurability wireless offerings for the small business market. Our products for facilitating broadband access in the home are available with features such as parental control capabilities and firewall security, to allow for safer, more controlled Internet usage in families with children. Our broadband products designed for the home market also contain installation software that guides a less sophisticated data networking user through the installation process with their broadband service provider, using a graphical user interface and simple point and click operations. Our connectivity product offerings for the home include powerline data transmission modes which allow home users to take advantage of their existing electrical wiring infrastructure for transmitting data among network components.

Competition

The small business and home networking markets are intensely competitive and subject to rapid technological change. We expect competition to continue to intensify. Our principal competitors include:

- within the small business networking market, companies such as 3Com Corporation, Allied Telesyn International, Buffalo, Inc., Dell Computer Corporation, D-Link, Hewlett-Packard Company, the Linksys division of Cisco Systems, Baracuda Networks, Inc. and SonicWALL, Inc.; and

- within the home networking market, companies such as Apple Inc., Belkin Corporation, D-Link, and the Linksys division of Cisco Systems.

Other current competitors include numerous local vendors such as Siemens Corporation, Devolo and AVM in Europe, Corega International SA and Melco, Inc. in Japan and TP-Link in China, and broadband equipment suppliers such as Actiontec Electronics, Inc., ARRIS Group, Inc., Comtrend Corporation, Huawei Technologies Co. Ltd., Motorola, Inc., Sagem Corporation, Scientific Atlanta a Cisco company, Thomson Corporation and

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2Wire, Inc. Our potential competitors include consumer electronics vendors and telecommunications equipment vendors who could integrate networking capabilities into their line of products, and our channel customers who may decide to offer self-branded networking products. We also face competition from service providers who may bundle a free networking device with their broadband service offering, which would reduce our sales if we are not the supplier of choice to those service providers.

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

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, price, 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 and enhancing our current products while continuing to expand our sales channels and maintaining customer satisfaction worldwide.

Research and Development

As of December 31, 2008, we had 158 employees engaged in research and development. We believe that our success depends on our ability to develop products that meet changing user needs and to anticipate and proactively respond to evolving technology in a timely and cost-effective manner. Accordingly, we have made investments in our research and development department in order to effectively evaluate new third party technologies, develop new in-house technologies, and develop and test new products. Our research and development employees work closely with our technology and manufacturing partners to bring our products to market in a timely, high quality and cost-efficient manner.

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

ODM. Under the original design manufacturer, or ODM, methodology, which we use for most of our product development activities, we define the product concept and specification and perform the technology selection. We then coordinate with our technology suppliers while they develop the chipsets, software and detailed circuit designs. On certain new products, one or more subsystems of the design can be done in-house and then integrated in with the remaining design pieces from the ODM. Once prototypes are completed, we work with our partners to complete the debugging and systems integration and testing. Our ODMs are responsible for conducting all of the regulatory agency approval processes required for each product. After completion of the final tests, agency approvals and product documentation, the product is released for production.

CM. Under the contract manufacturer, or CM, methodology, which we use for a limited number of products, we define the product concept and specification and develop the primary technology and software internally.

Once prototypes are completed, we work with our partners to complete the debugging and systems integration and testing. We are responsible for conducting all of the regulatory agency approval processes required for each product. After completion of the final tests, agency approvals and product documentation, the product is released for production.

IN-HOUSE DEVELOPMENT. Under the in-house development model, one or more subsystems of the product are designed and developed utilizing the NETGEAR engineering team. Under this model some of the primary technology is developed in-house. We then work closely with either an ODM or a contract manufacturer to complete the development of the entire design, perform the necessary testing, and obtain regulatory approvals before the product is released for production.

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

Our internal research and development efforts focus on developing and improving the usability, reliability, functionality, cost and performance of our products. Our total research and development expenses were $33.8 million in 2008, $28.1 million in 2007 and $18.4 million in 2006.

Manufacturing

Our primary manufacturers are Cameo Communications Inc., Delta Networks Incorporated, Hon Hai Precision Industry Co., Ltd. (more commonly known as Foxconn Corporation), SerComm Corporation, Kepro, and Unihan Corporation (which was spun out of ASUSTek Computer, Inc. in January 2008), all of which are headquartered in Taiwan. The actual manufacturing of our products occurs primarily in mainland China, with pilot and low-volume manufacturing in Taiwan on a select basis. We distribute our manufacturing among these key suppliers to avoid excessive concentration with a single supplier. In addition to their responsibility for the manufacturing of our products, our manufacturers purchase all necessary parts and materials to produce complete, finished goods. To maintain quality standards for our suppliers, we have established our own product quality organization based in Hong Kong and mainland China. They are responsible for auditing and inspecting process and product quality on the premises of our ODMs, CMs and OEMs.

We currently outsource warehousing and distribution logistics to four third-party providers who are responsible for warehousing, distribution logistics and order fulfillment. In addition, these parties are also responsible for some configuration and re-packaging of our products including bundling components to form kits, inserting appropriate documentation, disk drive configuration, and adding power adapters. APL Logistics Americas, Ltd. in City of Industry, California serves the Americas region, Kerry Logistics Ltd. in Hong Kong serves the Asia Pacific region, and DSV Solutions B.V. and ModusLink BV in the Netherlands serve the the United States and Europe, Middle-East and Africa, or EMEA, region.

Sales and Marketing

As of December 31, 2008, we had 266 employees engaged in sales and marketing. We work directly with our customers on market development activities, such as co-advertising, in-store promotions and demonstrations, instant rebate programs, event sponsorship and sales associate training. We also participate in major industry trade shows and marketing events. Our marketing department is comprised of our product marketing and corporate marketing groups.

Our product marketing group focuses on product strategy, product development roadmaps, the new product introduction process, product lifecycle management, demand assessment and competitive analysis. The group

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works closely with our sales and research and development groups to align our product development roadmap to meet customer technology demands from a strategic perspective. The group also ensures that product development activities, product launches, channel marketing program activities, and ongoing demand and supply planning occur in a well-managed, timely basis in coordination with our development, manufacturing, and sales groups, as well as our ODM, CM, OEM and sales channel partners.

Our corporate marketing group is responsible for defining and building our corporate brand. The group focuses on defining our mission, brand promise and marketing messages on a worldwide basis. This group also defines the marketing approaches in the areas of advertising, public relations, events, channel programs and our web delivery mechanisms. These marketing messages and approaches are customized for both the small business and home markets through a variety of delivery mechanisms designed to effectively reach end-users in a cost-efficient manner.

We conduct most of our international sales and marketing operations through NETGEAR International Ltd., our wholly-owned subsidiary which operates via sales and marketing subsidiaries and branch offices worldwide.

Customer Support

We design our products with plug and play ease of use. We respond globally to customer questions over the phone and Internet including providing an online Knowledgebase and User Forum. Customer support is provided through a combination of a limited number of permanent employees and use of subcontracted out-sourcing resources. Our permanent employees design our technical support database and are responsible for training and managing our outsourced sub-contractors. We utilize the information gained from customers by our customer support organization to enhance our product offerings, including further simplifying the installation process.

Intellectual Property

We believe that our continued success will depend primarily on the technical expertise, speed of technology implementation, creative skills and management abilities of our officers and key employees, plus ownership of a limited but important set of copyrights, trademarks, trade secrets and patents. We primarily rely on a combination of copyright, trademark and trade secret and patent laws, nondisclosure agreements with employees, consultants and suppliers and other contractual provisions to establish, maintain and protect our proprietary rights. We hold three issued patents that expire between years 2023 and 2025 and currently have a number of pending United States patent applications related to technology and products offered by us. In addition, we rely on third-party licensors for patented hardware and software license rights in technology that are incorporated into and are necessary for the operation and functionality of our products. Our success will depend in part on our continued ability to have access to these technologies.

We have trade secret rights for our products, consisting mainly of product design, technical product documentation and software. We also own, or have applied for registration of trademarks, in connection with our products, including NETGEAR, the NETGEAR logo, the NETGEAR Digital Entertainer logo, the Gear Guy logo, Connect with Innovation, Everybody s connecting, IntelliFi, ProSafe, RangeMax, ReadyNAS, Smart Wizard and X-RAID in the United States and internationally. We have registered a number of Internet domain names that we use for electronic interaction with our customers including dissemination of product information, marketing programs, product registration, sales activities, and other commercial uses.

Employees

As of December 31, 2008, we had 579 full-time employees, with 266 in sales, marketing and technical support, 158 in research and development, 65 in operations, and 90 in finance, information systems and administration. We also utilize a number of temporary staff to supplement our workforce. We have never had a work stoppage among our employees and no personnel are represented under collective bargaining agreements. We consider our relations with our employees to be good.

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Website Posting of SEC Filings

Our website provides a link to our SEC filings, which are available on the same day such filings are made. The specific location on the website where these reports can be found is *http://investor.netgear.com/sec.cfm*. Our website also provides a link to Section 16 filings which are available on the same day as such filings are made.

Executive Officers of the Registrant

The following table sets forth the names, ages and positions of our executive officers (who are subject to Section 16 of the Securities Exchange Act of 1934) as of February 17, 2009.

Name	Age	Position
Patrick C.S. Lo	52	Chairman and Chief Executive Officer
Mark G. Merrill	54	Chief Technology Officer
Michael F. Falcon	52	Senior Vice President of Operations
Christine M. Gorjanc	52	Chief Financial Officer
Andrew Kim	38	Vice President, Legal and Corporate Development
Charles T. Olson	53	Senior Vice President of Engineering
David Soares	42	Senior Vice President of Worldwide Sales
Michael A. Werdann	40	Vice President of Americas Sales

Patrick C.S. Lo has served as our Chairman and Chief Executive Officer since March 2002. From September 1999 to March 2002, he served as our President, and since our inception in 1996 to September 1999, he served as Vice President and General Manager. Mr. Lo joined Bay Networks, a networking company, in August 1995 to launch a division targeting the small business and home markets and established the NETGEAR division in January 1996. From 1983 until 1995, Mr. Lo worked at Hewlett-Packard Company, a computer and test equipment company, where he served in various management positions in software sales, technical support, network product management, sales support and marketing in the United States and Asia, including as the Asia/Pacific marketing director for Unix servers. Mr. Lo received a B.S. degree in Electrical Engineering from Brown University.

Mark G. Merrill has served as our Chief Technology Officer since January 2003. From September 1999 to January 2003, he served as Vice President of Engineering and served as Director of Engineering from September 1995 to September 1999. From 1987 to 1995, Mr. Merrill worked at SynOptics Communications, a local area networking company, which later merged with Wellfleet to become Bay Networks, where his responsibilities included system design and analog implementations for SynOptics first 10BASE-T products. Mr. Merrill received both a B.S. degree and an M.S. degree in Electrical Engineering from Stanford University.

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

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

Andrew Kim has served as our Vice President, Legal and Corporate Development and Corporate Secretary since October 2008 and as our Associate General Counsel since March 2008. Prior to joining NETGEAR, Mr. Kim served as Special Counsel in the Corporate and Securities Department of Wilson Sonsini Goodrich & Rosati, where he represented public and private technology companies in a wide range of matters, including mergers and acquisitions, debt and equity financing arrangements, securities law compliance and corporate governance. In between two terms at Wilson Sonsini Goodrich & Rosati, he served as Partner in the Business and Finance Department of Schwartz Cooper Chartered in Chicago, Illinois, and was an Adjunct Professor of Entrepreneurship at the Illinois Institute of Technology. Mr. Kim holds a J.D. from Cornell Law School, and received a B.A. degree in history from Yale University.

Charles T. Olson has served as our Senior Vice President of Engineering since March 2006 and our Vice President of Engineering since January 2003. From July 1978 to January 2003, Mr. Olson worked at Hewlett-Packard Company, a computer and test equipment company, where he served as Director of Research and Development for ProCurve networking from 1998 to 2003, as Research and Development Manager for the Enterprise Netserver division from 1997 to 1998, and, prior to that, in various other engineering management roles in Hewlett-Packard s Unix server and personal computer product divisions. Mr. Olson received a B.S. degree in Electrical Engineering from the University of California, Davis and an M.B.A. from Santa Clara University.

David Soares has served as our Senior Vice President of Worldwide Sales since August 2004. Mr. Soares joined us in January 1998, and served as Vice President of EMEA sales from December 2003 to July 2004, EMEA Managing Director from April 2000 to November 2003, United Kingdom and Nordic Regional Manager from February 1999 to March 2000 and United Kingdom Country Manager from January 1998 to January 1999. Prior to joining us, Mr. Soares was at Hayes Microcomputer Products, a manufacturer of dial-up modems. Mr. Soares attended Ridley College, Ontario Canada.

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

Item 1A. *Risk Factors*

Investing in our common stock involves a high degree of risk. The risks described below are not exhaustive of the risks that might affect our business. Other risks, including those we currently deem immaterial, may also impact our business. Any of the following risks could materially adversely affect our business operations, results of operations and financial condition and could result in a significant decline in our stock price.

Economic conditions are likely to materially adversely affect our revenue and results of operations.

Our business has been and may continue to be affected by a number of factors that are beyond our control such as general geopolitical economic and business conditions, conditions in the financial services markets, and changes in the overall demand for networking products. A severe and/or prolonged economic downturn could adversely affect our customers financial condition and the levels of business activity of our customers. Uncertainty about current global economic conditions could cause businesses to postpone spending in response

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to tighter credit, negative financial news and/or declines in income or asset values, which could have a material negative effect on the demand for networking products.

The current economic crisis affecting the banking system and financial markets and the current uncertainty in global economic conditions have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in credit, equity, currency and fixed income markets. There could be a number of follow-on effects from these economic developments and negative economic trends on our business, including the inability of customers to obtain credit to finance purchases of our products; customer insolvencies; decreased customer confidence to make purchasing decisions; decreased customer demand; and decreased customer ability to pay their trade obligations.

If conditions in the global economy, U.S. economy or other key vertical or geographic markets remain uncertain or weaken further, such conditions could have a material adverse impact on our business, operating results and financial condition. In addition, if we are unable to successfully anticipate changing economic and political conditions, we may be unable to effectively plan for and respond to those changes, which could materially adversely affect our business and results of operations.

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

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

We implemented a hedging program in November 2008 to hedge exposures to fluctuations in foreign currency exchange rates as a response to the risks of changes in the value of foreign currency denominated assets and liabilities. We may enter into foreign currency forward contracts or other instruments, the majority of which mature within approximately three months. Our foreign currency forward contracts reduce, but do not eliminate, the impact of currency exchange rate movements. For example, we do not execute forward contracts in all currencies in which we conduct business. In addition, our hedging program is not currently structured to reduce the impact, due to volatile exchange rates, on net revenues, gross profit and operating profit. Accordingly, the use of such hedging activities may not offset more than a portion of the adverse financial effect resulting from unfavorable movements in foreign exchange rates.

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 the risk factors section of this report and others such as:

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

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changes in the terms of our contracts with customers or suppliers that cause us to incur additional expenses or assume additional liabilities;

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

changes in or consolidation of our sales channels and wholesale distributor relationships or failure to manage our sales channel inventory and warehousing requirements;

delay or failure to fulfill orders for our products on a timely basis;

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

our inability to accurately forecast product demand;

unfavorable level of inventory and turns;

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

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

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

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

challenges associated with integrating acquisitions that we make;

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

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

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

our customers inability to pay for purchased goods in a timely fashion;

- bad debt exposure with our existing customers and as we expand into new international markets; and
- any changes in accounting rules.

As a result, period-to-period comparisons of our operating results may not be meaningful, and you should not rely on them as an indication of our future performance. In addition, our future operating results may fall below the expectations of public market analysts or investors. In that event, our stock price could decline significantly.

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

With the continuing uncertainty about economic conditions in the United States and abroad, there has been significant volatility in the market price and trading volume of securities of technology and other companies, which may be unrelated to the financial performance of these companies. These broad market fluctuations may negatively affect the market price of our common stock.

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

- actual or anticipated fluctuations in our operating results or our competitors operating results;
- actual or anticipated changes in the growth rate of the general networking sector, our growth rates or our competitors growth rates;
- conditions in the financial markets in general or changes in general economic conditions;

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- interest rate or currency exchange rate fluctuations;
- our ability or inability to raise additional capital; and
- changes in stock market analyst recommendations regarding our common stock, other comparable companies or our industry generally.

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

We compete in a rapidly evolving and highly competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors in the small business market include 3Com, Allied Telesyn, Buffalo, Dell, D-Link, Hewlett-Packard, the Linksys division of Cisco Systems and SonicWALL. Our principal competitors in the home market include Apple, Belkin, D-Link and the Linksys division of Cisco Systems. Our principal competitors in the broadband service provider market include Actiontec, ARRIS, Comtrend, Huawei, Motorola, Sagem, Scientific Atlanta a Cisco company, ZyXEL, Thomson and 2Wire. Other current and potential competitors include numerous local vendors such as Devolo, Siemens and AVM in Europe, Corega and Melco in Japan and TP-Link in China. Our potential competitors also include consumer electronics vendors who could integrate networking capabilities into their line of products, and our channel customers who may decide to offer self-branded networking products. We also face competition from service providers who may bundle a free networking device with their broadband service offering, which would reduce our sales if we are not the supplier of choice to those service providers.

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

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

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

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

Our business is subject to the risks of international operations.

We derive a significant portion of our revenue from international operations. As a result, our financial condition and operating results could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign subsidiaries), and changes in the value of the U.S. dollar versus local currencies. Margins on sales of our products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations.

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

We are currently involved in various litigation matters and may in the future become involved in additional litigation, including litigation regarding intellectual property rights, which could be costly and subject us to significant liability.

The networking industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding infringement of patents, trade secrets and other intellectual property rights. In particular, leading companies in the data communications markets, some of which are competitors, have extensive patent portfolios with respect to networking technology. From time to time, third parties, including these leading companies, have asserted and may continue to assert exclusive patent, copyright, trademark and other intellectual property rights against us demanding license or royalty payments or seeking payment for damages, injunctive relief and other available legal remedies through litigation. These include third parties who claim to own patents or other intellectual property that cover industry standards that our products comply with. If we are unable to resolve these matters or obtain licenses on acceptable or commercially reasonable terms, we could be sued or we may be forced to initiate litigation to protect our rights. The cost of any necessary licenses could significantly harm our business, operating results and financial condition. Also, at any time, any of these companies, or any other third party could initiate litigation against us, or we may be forced to initiate litigation against them, which could divert management attention, be costly to defend or prosecute, prevent us from using or selling the challenged technology, require us to design around the challenged technology and cause the price of our stock to decline. In addition, third parties, some of whom are potential competitors, have initiated and may continue to initiate litigation against our manufacturers, suppliers, members of our sales channels or our service provider customers, alleging infringement of their proprietary rights with respect to existing or future products. In the event successful claims of infringement are brought by third parties, and we are unable to obtain licenses or independently develop alternative technology on a timely basis, we may be subject to indemnification

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obligations, be unable to offer competitive products, or be subject to increased expenses. Finally, consumer class- action lawsuits related to the marketing and performance of our home networking products have been asserted and may in the future be asserted against us. For additional information regarding certain of the lawsuits in which we are involved, see the information set forth under Note 8 of the Notes to Consolidated Financial Statements in Part IV, Item 15 of this report, which information is incorporated into this Item 1A by reference. If we do not resolve these claims on a favorable basis, our business, operating results and financial condition could be significantly harmed.

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

Our products are complex and may contain defects, errors or failures, particularly when first introduced or when new versions are released. The industry standards upon which many of our products are based are also complex, experience change over time and may be interpreted in different manners. Some errors and defects may be discovered only after a product has been installed and used by the end-user. For example, in January 2008, we announced a voluntary recall of the XE103 Powerline Ethernet Adapter made for Europe and other countries using 220-240 volt power sources and sold individually or in a bundled kit. If our products contain defects or errors, or are found to be noncompliant with industry standards, we could experience decreased sales and increased product returns, loss of customers and market share, and increased service, warranty and insurance costs. In addition, our reputation and brand could be damaged, and we could face legal claims regarding our products. A product liability or other claim could result in negative publicity and harm our reputation, resulting in unexpected expenses and adversely impact our operating results. For instance, if a third party were able to successfully overcome the security measures in our products, such a person or entity could misappropriate customer data, third party data stored by our customers and other information, including intellectual property. In addition, the operations of our end user customers may be interrupted. If that happens, affected end-users or others may file actions against us alleging product liability, tort, or breach of warranty claims.

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

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

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

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and brand;
- a decline in the average selling price of our products;
- adverse reactions in our sales channels, such as reduced shelf space, reduced online product visibility, or loss of sales channel; and
- increased levels of product returns.

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

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

Traditional retailers have limited shelf space and promotional budgets, and competition is intense for these resources. If the networking sector does not experience sufficient growth, retailers may choose to allocate more shelf space to other consumer product sectors. A competitor with more extensive product lines and stronger brand identity, such as Cisco Systems, may have greater bargaining power with these retailers. Any reduction in available shelf space or increased competition for such shelf space would require us to increase our marketing expenditures simply to maintain current levels of retail shelf space, which would harm our operating margin. The recent trend in the consolidation of online retailers and DMR channels has resulted in intensified competition for preferred product placement, such as product placement on an online retailer s Internet home page. Expanding our presence in the VAR channel may be difficult and expensive. We compete with established companies that have longer operating histories and longstanding relationships with VARs that we would find highly desirable as sales channel partners. We have limited experience selling to broadband service providers. Penetrating service provider accounts typically involves a long sales cycle and the challenge of displacing incumbent suppliers with established relationships and field-deployed products. If we were unable to maintain and expand our sales channels, our growth would be limited and our business would be harmed.

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

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

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

In the past, there have been bankruptcies amongst our customer base. Although any resulting loss has not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. To the degree that the recent turmoil in the credit markets makes it more difficult for some customers to obtain financing, our customers ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business, operating results, and financial condition.

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

We sell a substantial portion of our products through broadband service providers worldwide. We face a number of challenges associated with penetrating, marketing and selling to the broadband service provider channel that differ from what we have traditionally faced with the other channels. These challenges include a longer sales cycle, more stringent product testing and validation requirements, a higher level of customization demands, requirements that suppliers take on a larger share of the risk with respect to contractual business terms, competition from established suppliers, pricing pressure resulting in lower gross margins, and our general inexperience in selling to service providers. Orders from service providers generally tend to be large but sporadic, which causes our revenues from them to fluctuate and challenges our ability to accurately forecast demand from them. In certain cases, we may commit to fixed price long term purchase orders, with such orders priced in foreign currencies which could lose value over time in the event of adverse changes in foreign exchange rates. Even if we are selected as a supplier, typically a service provider will also designate a second source supplier, which over time will reduce the aggregate orders that we receive from that service provider. If we were to lose a service provider customer for any reason, we may experience a material and immediate reduction in forecasted revenue that may cause us to be below our net revenue and operating margin guidance for a particular period of time and therefore adversely affect our stock price. In addition, service providers may choose to prioritize the implementation of other technologies or the roll out of other services than home networking. Weakness in orders from this industry could have a material adverse effect on our business, operating results, and financial condition. We have seen a slowdown in capital expenditures by certain of our service provider customers, and believe there may be potential for a broader slowdown in the global service provider market in the next few quarters. Any slowdown in the general economy, over capacity, consolidation among service providers, regulatory developments and constraint on capital expenditures could result in reduced demand from service providers and therefore adversely affect our sales to them. If we do not successfully overcome these challenges, we will not be able to profitably grow our service provider sales channel and our growth will be slowed.

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

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

As part of growing our business, we have made and expect to continue to make acquisitions. If we fail to successfully select, execute or integrate our acquisitions, or if stock market analysts or our stockholders do not support the acquisitions that we choose to execute, then our business and operating results could be harmed and our stock price could decline.

From time to time, we will undertake acquisitions to add new product lines and technologies, gain new sales channels or enter into new sales territories. Acquisitions involve numerous risks and challenges, including but not limited to the following:

- integrating the companies, assets, systems, products, sales channels and personnel that we acquire;

- growing or maintaining revenues to justify the purchase price and the increased expenses associated with acquisitions;

entering into territories or markets that we have limited or no prior experience with;

establishing or maintaining business relationships with customers, vendors and suppliers who may be new to us;

overcoming the employee, customer, vendor and supplier turnover that may occur as a result of the acquisition; and

diverting management s attention from running the day to day operations of our business.

As part of undertaking an acquisition, we may also significantly revise our capital structure or operational budget, such as issuing common stock that would dilute the ownership percentage of our stockholders, assuming liabilities or debt, utilizing a substantial portion of our cash resources to pay for the acquisition or significantly increasing operating expenses. Our acquisitions have resulted and may in the future result in charges being taken in an individual quarter as well as future periods, which results in variability in our quarterly earnings. In addition, our effective tax rate in any particular quarter may also be impacted by acquisitions.

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

We have recently upgraded our financial, demand planning and operational management systems. If we experience problems with the initial deployment and operation of these new systems, our business and operations will be adversely affected.

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

If disruptions in our transportation network occur or our shipping costs substantially increase, we may be unable to sell or timely deliver our products and our operating expenses could increase.

We are highly dependent upon the transportation systems we use to ship our products, including surface and air freight. Our attempts to closely match our inventory levels to our product demand intensify the need for our transportation systems to function effectively and without delay. On a quarterly basis, our shipping volume also tends to steadily increase as the quarter progresses, which means that any disruption in our transportation network in the latter half of a quarter will have a more material effect on our business than at the beginning of a quarter.

The transportation network is subject to disruption or congestion from a variety of causes, including labor disputes or port strikes, acts of war or terrorism, natural disasters and congestion resulting from higher shipping volumes. Labor disputes among freight carriers and at ports of entry are common, especially in Europe, and we expect labor unrest and its effects on shipping our products to be a continuing challenge for us. The labor unions for the ports in the west coast of the U.S. are now engaging in contract negotiation with the port operators. If the negotiation falters and results in strikes, it will severely impact our business. Since September 11, 2001, the rate of inspection of international freight by governmental entities has substantially increased, and has become increasingly unpredictable. If our delivery times increase unexpectedly for these or any other reasons, our ability to deliver products on time would be materially adversely affected and result in delayed or lost revenue as well as customer imposed penalties. In addition, if increases in fuel prices occur, our transportation costs would likely increase. Moreover, the cost of shipping our products by air freight is greater than other methods. From time to time in the past, we have shipped products using air freight to meet unexpected spikes in demand, shifts in demand between product categories 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 year ended December 31, 2008, sales to Ingram Micro and its affiliates accounted for 14% of our net revenue and sales to Tech Data and its affiliates accounted for 11% of our net revenue. We expect that a significant portion of our net revenue will continue to come from sales to a small number of wholesale distributors for the foreseeable future. In addition, because our accounts receivable are concentrated with a small group of purchasers, the failure of any of them to pay on a timely basis, or at all, would reduce our cash flow. We generally have no minimum purchase commitments or long-term contracts with any of these distributors. These purchasers could decide at any time to discontinue, decrease or delay their purchases of our products. In addition, the prices that they pay for our products are subject to negotiation and could change at any time. If any of our major wholesale distributors reduce their level of purchases or refuse to pay the prices that we set for our products, our net revenue and operating results could be harmed. If our wholesale distributors increase the size of their product orders without sufficient lead-time for us to process the order, our ability to fulfill product demands would be compromised.

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

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

As a result of our acquisitions, we have significant goodwill and amortizable intangible assets recorded on our balance sheet. In addition, significant negative industry or economic trends, such as those that have occurred in the last six months, including reduced estimates of future cash flows or disruptions to our business could indicate that goodwill or amortizable intangible assets might be impaired. If, in any period like the fourth quarter of 2008, our stock price decreases to the point where our market capitalization is less than our book value, this too could indicate a potential impairment and we may be required to record an impairment charge in that period. In the fourth quarter of 2008, we recorded an impairment charge of $458,000 for the net carrying value of certain intangible assets acquired in connection with the Company s 2006 acquisition of Skipjam Corp. due to the departure of a key employee responsible for managing the asset group as well as recent economic conditions. In conducting our annual impairment test for goodwill during the fourth quarter of 2008, our fair value exceeded the carrying value of our net assets by approximately 12%. As such, no goodwill impairment loss was recorded.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on projections of future operating performance. We operate in highly competitive environments and projections of future operating results and cash flows may vary significantly from actual results. As a result, we may incur substantial impairment charges to earnings in our financial statements should an impairment of our goodwill or amortizable intangible assets be determined resulting in an adverse impact on our results of operations.

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

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

From time to time, we are audited by various federal, state and foreign authorities regarding tax matters. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit and, in some cases, appeal or litigation process. As each audit is concluded, adjustments, if any, are appropriately recorded in our financial statements in the period determined. To provide for potential tax exposure, we maintain a liability for uncertain tax positions in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48). However, if these accrued liabilities and/or reserves are insufficient upon completion of any audit process, there could be an adverse impact on our financial position and results of operations.

Changes in our tax rates could affect our future results.

Our future effective tax rates are affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or by changes in tax laws or their interpretation. As a result our effective tax rates 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 effective tax rates were to increase significantly, our quarterly and annual results would be negatively impacted and the price of our stock could decline. Therefore, period-to-period comparisons of our operating results may not be meaningful, and you should not rely on them as an indication of our future performance. In addition, our future operating results may fall below the expectations of public market analysts or investors. In that event, our stock price could decline significantly.

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

All of our products are manufactured, assembled, tested and generally packaged by a limited number of original design manufacturers (ODMs), contract manufacturers (CMs) and original equipment manufacturers (OEMs). We rely on our manufacturers to procure components and, in some cases, subcontract engineering work. Some of our products are manufactured by a single manufacturer. We do not have any long-term contracts with any of our third party manufacturers. Some of these third party manufacturers produce products for our competitors. Due to weakening economic conditions, the viability of some of these third party manufacturers may be at risk. The loss of the services of any of our primary third party manufacturers could cause a significant disruption in operations and delays in product shipments. Qualifying a new manufacturer and commencing volume production is expensive and time consuming.

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

- unexpected increases in manufacturing and repair costs;

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

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

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

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

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

We rely on third parties to obtain non-exclusive patented hardware and software license rights in technologies that are incorporated into and necessary for the operation and functionality of most of our products. In these cases, because the intellectual property we license is available from third parties, barriers to entry 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.

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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.

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 60% of overall net revenue in fiscal 2008. We anticipate that international sales may grow as a percentage of net revenue. We have committed resources to expanding our international operations and sales channels and these efforts may not be successful. International operations are subject to a number of other risks, including:

- political and economic instability, international terrorism and anti-American sentiment, particularly in emerging markets;
- preference for locally branded products, and laws and business practices favoring local competition;
- exchange rate fluctuations;
- increased difficulty in managing inventory;
- delayed revenue recognition;
- less effective protection of intellectual property;
- stringent consumer protection and product compliance regulations, including but not limited to the recently enacted Restriction of Hazardous Substances directive and the Waste Electrical and Electronic Equipment directive in Europe, that may vary from country to country and that are costly to comply with;
- difficulties and costs of staffing and managing foreign operations; and

changes in local tax laws.

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

We intend to expand our operations and pursue market opportunities domestically and internationally to grow our sales. We expect that this attempted expansion will require enhancements to our existing management

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

Governmental regulations of imports or exports affecting Internet security could affect our net revenue.

Any additional governmental regulation of imports or exports or failure to obtain required export approval of our encryption technologies could adversely affect our international and domestic sales. The United States and various foreign governments have imposed controls, export license requirements, and restrictions on the import or export of some technologies, especially encryption technology. In addition, from time to time, governmental agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. In response to terrorist activity, governments could enact additional regulation or restriction on the use, import, or export of encryption technology. This additional regulation of encryption technology could delay or prevent the acceptance and use of encryption products and public networks for secure communications, resulting in decreased demand for our products and services. In addition, some foreign competitors are subject to less stringent controls on exporting their encryption technologies. As a result, they may be able to compete more effectively than we can in the United States and the international Internet security market.

We recently moved into a new corporate headquarters in the third quarter of 2008. If we cannot retain sub lessees for the remaining lease term of our old facilities, then we will be forced to take an additional charge related to such excess space.

We recently moved into our new corporate headquarters in the third quarter of 2008. The existing lease on our former Santa Clara corporate headquarters does not expire until the end of 2010 and the existing lease on our Fremont facility does not expire until the end of October 2009. We have subleased a portion of these facilities and taken a restructuring charge for the balance of the lease costs. If any tenant moves out or is unable to meet its obligations to us, we would have to record an additional charge associated with such excess space.

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

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

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

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

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

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

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

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

- our reseller agreements generally do not require substantial minimum purchases;
- our customers can stop purchasing and our resellers can stop marketing our products at any time; and
- our reseller agreements generally are not exclusive and are for one-year terms, with no obligation of the resellers to renew the agreements.

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

We are required to expense equity compensation given to our employees, which could reduce our reported earnings, could significantly impact our operating results in future periods and could reduce our stock price and our ability to effectively utilize equity compensation to attract and retain employees.

We historically have used stock options as a significant component of our employee compensation program in order to align employees interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes that require companies to record a charge to earnings for employee stock option grants and other equity incentives. As a result, we have experienced a substantial increase in compensation costs, and these charges could further significantly impact our operating results in future periods. This could require us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Moreover, if securities analysts, institutional investors and other investors adopt financial models that include stock option expense in their primary analysis of our financial results, our stock price could decline as a result of reliance on these models with higher expense calculations. Each of these results could materially and adversely affect our business.

We are exposed to credit risk and fluctuations in the market values of our investment portfolio.

Although we have not recognized any material losses on our cash equivalents and short-term investments, future declines in their market values could have a material adverse effect on our financial condition and operating results. Given the global nature of our business, we have investments both domestically and

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internationally. A substantial portion of our money market funds are insured by the U.S. Treasury s temporary guarantee program, which expires in April 2009. If these financial institutions default on their obligations or their credit ratings are negatively impacted by liquidity issues, credit deterioration or losses, financial results, or other factors, the value of our cash equivalents and short-term investments could decline and result in a material impairment, which could have a material adverse effect on our financial condition and operating results.

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

Our corporate headquarters are located in Northern California and one of our warehouses is located in Southern California, regions known for seismic activity. In addition, substantially all of our manufacturing occurs in two geographically concentrated areas in mainland China, where disruptions from natural disasters, health epidemics and political, social and economic instability may affect the region. If our manufacturers or warehousing facilities are disrupted or destroyed, we would be unable to distribute our products on a timely basis, which could harm our business. Moreover, if our computer information systems or communication systems, or those of our vendors or customers, are subject to disruptive hacker attacks or other disruptions, our business could suffer. We have not established a formal disaster recovery plan. Our back-up operations may be inadequate and our business interruption insurance may not be enough to compensate us for any losses that may occur. A significant business interruption could result in losses or damages and harm our business. For example, much of our order fulfillment process is automated and the order information is stored on our servers. If our computer systems and servers go down even for a short period at the end of a fiscal quarter, our ability to recognize revenue would be delayed until we were again able to process and ship our orders, which could cause our stock price to decline significantly.

We depend significantly on worldwide economic conditions and their impact on levels of consumer spending, which have recently deteriorated significantly in many countries and regions, including without limitation the United States, and may remain depressed for the foreseeable future. Factors that could influence the levels of consumer spending include increases in fuel and other energy costs, conditions in the residential real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence and other macroeconomic factors affecting consumer spending behavior.

In addition, war, terrorism, geopolitical uncertainties, public health issues, and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a strong negative effect on us, our suppliers, logistics providers, manufacturing vendors and customers. Our business operations are subject to interruption by natural disasters, fire, power shortages, terrorist attacks, and other hostile acts, labor disputes, public health issues, and other events beyond our control. Such events could decrease demand for our products, make it difficult or impossible for us to make and deliver products to our customers or to receive components from our suppliers, and create delays and inefficiencies in our supply chain. Should major public health issues, including pandemics, arise, we could be negatively affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products, and disruptions in the operations of our manufacturing vendors and component suppliers.

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

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

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Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our principal administrative, sales, marketing and research and development facilities currently occupy approximately 142,700 square feet in an office complex in San Jose, California, under a lease that expires in March 2018.

Our international headquarters occupy approximately 10,000 square feet in an office complex in Cork, Ireland, under a lease entered into in February 2006 and expiring in December 2026. Our international sales personnel reside in local sales offices or home offices in Austria, Australia, Brazil, China, Czech Republic, Denmark, France, Germany, Hong Kong, India, Italy, Japan, Korea, Mexico, New Zealand, Norway, Poland, Russia, Singapore, Spain, Sweden, Switzerland, the Netherlands, the United Arab Emirates, and the United Kingdom. We also have operations personnel using a leased facility in Hong Kong. We also maintain research and development facilities in Beijing, Guangzhou, Nanjing, and Shanghai, China, and in Taipei, Taiwan. From time to time we consider various alternatives related to our long-term facilities needs. While we believe our existing facilities are adequate to meet our immediate needs, it may be necessary to lease additional space to accommodate future growth.

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

Item 3. ***Legal Proceedings***

The information set forth under Note 8 of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Form 10-K, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled Risk Factors in Part I, Item 1A of this Form 10-K.

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

No matters were submitted to a vote of the security holders during the fourth quarter ended December 31, 2008.

PART II

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

Market Information

Our common stock has been quoted under the symbol NTGR on the Nasdaq National Market from July 31, 2003 to July 1, 2006, and on the Nasdaq Global Select Market since then. Prior to that time, there was no public market for our common stock. The following table sets forth for the indicated periods the high and low sales prices for our common stock on the Nasdaq markets. Such information reflects interdealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

Fiscal Year Ended December 31, 2007	High	Low
First Quarter	$ 31.31	$ 25.00
Second Quarter	38.75	28.50
Third Quarter	41.33	25.85
Fourth Quarter	37.00	29.70

Fiscal Year Ended December 31, 2008	High	Low
First Quarter	$ 34.92	$ 18.58
Second Quarter	20.68	13.80
Third Quarter	17.50	12.41
Fourth Quarter	15.17	8.21

On February 17, 2009, there were 37 stockholders of record.

Equity Compensation Plan Information

The following table provides information as of December 31, 2008 about our common stock that may be issued upon the exercise of options and rights granted to employees or members of our Board of Directors under all existing equity compensation plans, including the 2000 Plan (which was terminated as to new grants in May 2003), the 2003 Stock Plan, the 2006 Long Term Incentive Plan, the 2006 Stand-Alone Stock Option Agreement and the 2003 Employee Stock Purchase Plan.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders	4,081,753(1)	$ 19.82	2,682,229(2)
Equity compensation plans not approved by security holders	68,749(3)	$ 19.16	
Total	4,150,502	$ 19.81	2,682,229

(1) Includes 1,580,422 shares outstanding under the 2003 Plan, 2,501,331 shares outstanding under the 2006 Plan and no outstanding shares under the 2003 Employee Stock Purchase Plan.

(2) Includes 160,737 shares available for issuance under the 2003 Plan, 2,345,289 shares available for issuance under the 2006 Plan and 176,203 shares available for issuance under the 2003 Employee Stock Purchase Plan.

(3) Consists of 68,749 shares outstanding under the 2006 Stand-Alone Stock Option Agreement.

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Company Performance

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

The following graph shows a comparison from December 31, 2003 through December 31, 2008 of cumulative total return for our common stock, the Nasdaq Composite Index and the Nasdaq Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Nasdaq Computer Index assume reinvestment of dividends. We have never paid dividends on our common stock and have no present plans to do so.

	December 31, 2003	December 31, 2004	December 31, 2005	December 31, 2006	December 31, 2007	December 31, 2008
NETGEAR, Inc.	$ 100.00	$ 113.57	$ 120.39	$ 164.17	$ 223.08	$ 71.36
NASDAQ Computer Index	$ 100.00	$ 103.25	$ 106.09	$ 112.61	$ 137.22	$ 73.15
NASDAQ Composite Index	$ 100.00	$ 108.59	$ 110.08	$ 120.56	$ 132.39	$ 78.72

Dividend Policy

We have never declared or paid cash dividends on our capital stock. We currently intend to retain future earnings, if any, to finance the operation and expansion of our business, and we do not anticipate paying cash dividends in the foreseeable future.

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Repurchase of Equity Securities by the Company

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2008-January 31, 2008	5,448	$ 28.79		
February 1, 2008-February 29, 2008				
March 1, 2008-March 31, 2008				
April 1, 2008-April 30, 2008				
May 1, 2008-May 31, 2008	1,403	18.40		
June 1, 2008-June 30, 2008				
July 1, 2008-July 31, 2008				
August 1, 2008-August 31, 2008				
September 1, 2008-September 30, 2008				
October 1, 2008-October 31, 2008	174,341	8.95	173,000	5,827,000
November 1, 2008-November 30, 2008	995,780	10.52	995,780	4,831,220
December 1, 2008-December 31, 2008	805	11.15		4,831,220
	1,177,777	$ 10.38	1,168,780	4,831,220

On October 21, 2008, our Board of Directors authorized management to repurchase up to 6,000,000 shares of our outstanding common stock. Under this authorization, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and our share price. During the fiscal year ended December 31, 2008, we repurchased approximately 1.2 million shares or $12.0 million of common stock under this repurchase authorization. Additionally, we repurchased approximately 9,000 shares or $206,000 of common stock related to the lapse of restricted stock units during the year ended December 31, 2008.

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Item 6. ***Selected Consolidated Financial Data***

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

We derived the selected consolidated statement of operations data for the years ended December 31, 2008, 2007 and 2006 and the selected consolidated balance sheet data as of December 31, 2008 and 2007 from our audited consolidated financial statements appearing elsewhere in this Form 10-K. We derived the selected consolidated statement of operations data for the years ended December 31, 2005 and 2004 and the selected consolidated balance sheet data as of December 31, 2006, 2005 and 2004 from our audited consolidated financial statements, which are not included in this Form 10-K. Historical results are not necessarily indicative of results to be expected for future periods.

	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(In thousands, except per share data)				
Consolidated Statement of Operations Data:					
Net revenue	$ 743,344	$ 727,787	$ 573,570	$ 449,610	$ 383,139
Cost of revenue(2)	502,320	485,180	379,911	297,911	260,318
Gross profit	241,024	242,607	193,659	151,699	122,821
Operating expenses:					
Research and development(2)	33,773	28,070	18,443	12,837	10,316
Sales and marketing(2)	121,687	117,938	91,881	71,345	62,247
General and administrative(2)	31,733	27,220	20,905	14,559	14,905
Restructuring	1,929				
In-process research and development	1,800	4,100	2,900		
Litigation reserves, net	711	167		802	
Total operating expenses	191,633	177,495	134,129	99,543	87,468
Income from operations	49,391	65,112	59,530	52,156	35,353
Interest income, net	4,336	8,426	6,974	4,104	1,593
Other income (expense), net	(8,384)	3,298	2,495	(1,770)	(560)
Income before income taxes	45,343	76,836	68,999	54,490	36,386
Provision for income taxes	27,293	30,882	27,867	20,867	12,921
Net income	$ 18,050	$ 45,954	$ 41,132	$ 33,623	$ 23,465
Net income per share:					
Basic(1)	$ 0.51	$ 1.32	$ 1.23	$ 1.04	$ 0.77
Diluted(1)	$ 0.51	$ 1.28	$ 1.19	$ 0.99	$ 0.72

(1) Information regarding calculation of per share data is described in Note 5 of the Notes to Consolidated Financial Statements.
(2) Stock-based compensation expense was allocated as follows:

Cost of revenue	$ 864	$ 633	$ 430	$ 147	$ 163
Research and development	3,218	2,391	1,119	293	400
Sales and marketing	3,406	3,013	1,405	375	733

General and administrative	3,835	2,842	1,551	249	391

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Effective January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R).

	December 31,				
	2008	2007	2006	2005	2004
			(In thousands)		
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 203,009	$ 205,343	$ 197,465	$ 173,656	$ 141,715
Working capital	$ 312,843	$ 311,082	$ 280,877	$ 230,416	$ 180,696
Total assets	$ 586,209	$ 551,109	$ 437,904	$ 356,297	$ 300,238
Total current liabilities	$ 176,505	$ 168,507	$ 143,482	$ 120,293	$ 115,044
Total stockholders equity	$ 390,958	$ 371,523	$ 294,422	$ 236,004	$ 185,194

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

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

Business Overview

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

Our product line consists of wired and wireless devices that enable Ethernet networking, broadband access, and network connectivity. These products are available in multiple configurations to address the needs of our end-users in each geographic region in which our products are sold.

We sell our networking products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, DMRs, VARs, and broadband service providers. Our retail channel includes traditional retail locations domestically and internationally, such as Best Buy, 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, Dell, Newegg.com and Buy.com. Our DMRs include CDW Corporation, Insight Corporation and PC Connection in domestic markets and Misco throughout Europe. In addition, we also sell our products through broadband service providers, such as multiple system operators (MSOs), DSL, and other broadband technology operators domestically and internationally. Some of these retailers and broadband service providers purchase directly from us while others are fulfilled through wholesale distributors around the world. A substantial portion of our net revenue to date has been derived from a limited number of wholesale distributors, 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.

We have well developed channels in the United States and Europe, Middle-East and Africa, or EMEA, and are building a strong presence in the Asia Pacific and Latin American regions. We derive the majority of our net revenue from international sales. International sales as a percentage of net revenue decreased from 62% in 2007 to 60% in 2008. International sales decreased from $454.1 million in 2007 to $445.7 million in 2008, representing a decrease of approximately 1.8% during that period. We continue to penetrate new markets such as Brazil, Russia and Eastern Europe, India, and the Middle-East.

Our net revenue grew 2.1% during the year ended December 31, 2008 primarily attributable to increased shipments in our wireless-G products to existing service provider customers as well as sales of our ReadyNAS products, which were acquired in connection with our May 16, 2007 acquisition of Infrant Technologies, Inc. (Infrant). We have also experienced growth in wireless-N router sales. The growth was offset by a decrease in DSL gateway products sold.

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 resources in developing new products and enhancing our current products while continuing to expand our channels and maintaining customer satisfaction worldwide.

The current recessionary environment and overall weakness in consumer demand will negatively impact net revenue in the coming year. We expect global sales to decline as weakness in the U.S. and United Kingdom is spreading to continental Europe and Australia. We anticipate further erosion of our gross and operating margins in the first quarter of 2009 due to our foreign currency business exposure. However, we foresee our operating margin improving in the second quarter of 2009 when our local currency pricing actions have had a chance to catch up with the strength of the rising U.S. dollar and our new products will have a meaningful margin impact. In the interim, we are taking immediate actions to reduce our cost structure and improve our operating margins. In this effort, we plan to reduce the variable components of employee compensation, reduce the base compensation of executives and country managers by 10%, forego bonuses for all executives and eligible employees in 2009, as well as reduce overall headcount through natural attrition.

Our gross margin decreased to 32.4% for the year ended December 31, 2008, from 33.3% for the year ended December 31, 2007, primarily attributable to sales of products carrying lower gross margins to service providers and the impact on our foreign currency denominated revenues due to the strengthening of the U.S. dollar, as well as higher warranty costs associated with end-user warranty returns. Additionally, inventory reserves increased primarily due to selling prices of certain products, primarily attributable to the strengthening of the U.S. dollar in locations where we bill in local currencies, falling below cost. These negative margin impacts were partially mitigated by reduced air freight expenses as a result of increased on-hand inventory levels, as well as reduced marketing expenses. Operating expenses for the year ended December 31, 2008 were $191.6 million, or 25.8% of net revenue, compared to $177.5 million, or 24.4% of net revenue, for the year ended December 31, 2007. This increase was primarily attributable to higher legal fees of $3.5 million, a $3.0 million increase in salary and other employee related expenses, and a $2.2 million increase in stock based compensation.

Net income decreased $27.9 million, or 60.7%, to $18.1 million for the year ended December 31, 2008, from $46.0 million for the year ended December 31, 2007. This decrease was primarily attributable to an increase in operating expenses of $14.1 million, a decrease in other income (expense), net, of $11.7 million, and a decrease in interest income, net, of $4.1 million. These decreases in pre-tax income were offset by a decrease in provision for income taxes of $3.6 million.

Critical Accounting Policies and Estimates

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

Revenue Recognition

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

Allowances for Product Warranties, Returns due to Stock Rotation, Price Protection, Sales Incentives and Doubtful Accounts

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

In addition to warranty-related returns, certain distributors and retailers generally have the right to return product for stock rotation purposes. Every quarter, stock rotation rights are generally limited to 10% of invoiced sales to the distributor or retailer in the prior quarter. Upon shipment of the product, we reduce revenue for an estimate of potential future stock rotation returns related to the current period product revenue. We analyze historical returns, channel inventory levels, current economic trends and changes in customer demand for our products when evaluating the adequacy of the allowance for sales returns, namely stock rotation returns. Our estimated allowances for returns due to stock rotation can vary from actual results and we may have to record additional revenue reductions which could materially impact our financial position and results of operations.

Sales incentives provided to customers are accounted for in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9. Under these guidelines, we accrue for sales incentives as a marketing expense if we receive an identifiable benefit in exchange and can reasonably estimate the fair value of the identifiable benefit received; otherwise, it is recorded as a reduction of revenues. Our estimated provisions for sales incentives can vary from actual results and we may have to record additional expenses or additional revenue reductions dependent on the classification of the sales incentive.

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

Valuation of Inventory

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

Goodwill and intangibles

We apply SFAS No. 142, Goodwill and Other Intangible Assets and perform an annual goodwill impairment test. Should certain events or indicators of impairment occur between annual impairment tests, we will perform the impairment test as those events or indicators occur. For purposes of impairment testing, we have determined that we have only one reporting unit.

The goodwill impairment test involves a two-step process. In the first step, we estimate our fair value and compare the fair value with the carrying value of our net assets. If the fair value is greater than the carrying value of our net assets, then no impairment results. If the fair value is less than our carrying value, then we would perform the second step and determine the fair value of the goodwill. In this second step, the amount of impairment is determined by comparing the implied fair value to the carrying value of the goodwill in the same manner as if we were being acquired in a business combination. Specifically, we would allocate the fair value to all of our assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded to earnings in the Consolidated Statements of Operations.

In addition, we would evaluate goodwill for impairment if events or circumstances change between annual tests indicating a possible impairment. Examples of such events or circumstances include the following: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in the business climate; the testing for recoverability of a significant asset group; and slower growth rates.

In the fourth quarter of fiscal 2008, we completed the annual impairment test of goodwill. Our fair value was determined using a combination of the income approach and the market approach. Under the market approach, we utilized our own information as well as publicly available industry information to determine earnings multiples and revenue multiples that were used to value the Company. Under the income approach, we determined the fair value based on estimated future cash flows, discounted by an estimated weighted-average cost of capital, which reflects our overall level of inherent risk and the rate of return an outside investor would expect to earn. Determining our fair value is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others.

Solely for the purpose of establishing inputs for the fair value calculation, we made the following assumptions. For the income approach, a 3% growth factor was used to calculate our terminal value and the discount rate was estimated at 20%. For the market approach, we applied a control premium of 30% which seeks to give effect to the increased consideration a potential acquirer would be required to pay in order to gain sufficient ownership to set policies, direct operations and make decisions related to the Company. In conducting our impairment test in the fourth quarter of 2008, we determined the fair value of the Company exceeded the carrying value of our net assets by approximately 12%. No goodwill impairment loss was recognized in the years ended December 31, 2006, 2007, or 2008.

Given the current economic environment and the uncertainties regarding the impact on our business, there can be no assurance that our estimates and assumptions regarding the duration of the ongoing economic downturn, or the period or strength of recovery, made for purposes of our goodwill impairment testing during the year ended December 31, 2008 will prove to be accurate predictions of the future. If our assumptions regarding forecasted revenue or earnings are not achieved, we may be required to record goodwill impairment charges in future periods, whether in connection with our next annual impairment testing in the fourth quarter of 2009 or prior to that, if any such change constitutes a triggering event outside of the quarter from when the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from two to five years. Purchased intangible assets determined to have indefinite useful lives are not amortized. Long-lived assets, including property and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Such conditions may include an economic downturn or a change in the assessment of future operations. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

In the fourth quarter of 2008, a key employee responsible for managing the asset group acquired in connection with our 2006 acquisition of Skipjam Corp. departed the Company. The departure of this employee, along with the recent economic environment, resulted in our decision to reduce efforts geared at marketing the related products. As a result, we performed an impairment analysis of these long-lived assets during the fourth quarter of 2008. Based on the results of the analysis, we recorded an impairment charge within cost of revenue in the Consolidated Statements of Operations of $458,000 for the net carrying value of intangibles acquired in connection with our 2006 acquisition of Skipjam Corp. During the years ended December 31, 2007 and 2006, there were no events or changes in circumstances that indicated the carrying amount of our long-lived assets may not be recoverable from their undiscounted cash flows. Consequently, we did not perform an impairment test or record an impairment of our long-lived assets during those periods.

We will continue to evaluate the carrying value of our long-lived assets and if we determine in the future that there is a potential further impairment, we may be required to record additional charges to earnings which could affect our financial results.

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Income Taxes

We account for income taxes under an asset and liability approach. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences resulting from different treatments for tax versus accounting of certain items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. As of December 31, 2008, we believe that all of our deferred tax assets are recoverable; however, if there were a change in our ability to recover our deferred tax assets, we would be required to take a charge in the period in which we determined that recovery was not more likely than not.

We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48) on January 1, 2007. FIN 48 clarifies the accounting for uncertain income tax positions recognized in an enterprise s financial statements in accordance with Statement SFAS No. 109, Accounting for Income Taxes. It provides that a company should use a more-likely-than-not recognition threshold based on the technical merits of the income tax position taken. Income tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. As a result of adoption, we recorded a reduction in tax liability of $255,000 and a corresponding increase in retained earnings as of January 1, 2007. We include interest expense and penalties related to uncertain tax positions as additional tax expense.

Results of Operations

The following table sets forth the Consolidated Statements of Operations and the percentage change from the preceding year for the periods indicated:

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
Net revenue	$ 743,344	2.1%	$ 727,787	26.9%	$ 573,570
Cost of revenue	502,320	3.5%	485,180	27.7%	379,911
Gross profit	241,024	(0.7)%	242,607	25.3%	193,659
Operating expenses:					
Research and development	33,773	20.3%	28,070	52.2%	18,443
Sales and marketing	121,687	3.2%	117,938	28.4%	91,881
General and administrative	31,733	16.6%	27,220	30.2%	20,905
Restructuring	1,929	**		**	
In-process research and development	1,800	(56.1)%	4,100	41.4%	2,900
Litigation reserves, net	711	325.7%	167	**	
Total operating expenses	191,633	8.0%	177,495	32.3%	134,129
Income from operations	49,391	(24.1)%	65,112	9.4%	59,530
Interest income, net	4,336	(48.5)%	8,426	20.8%	6,974
Other income (expense), net	(8,384)	**	3,298	32.2%	2,495
Income before income taxes	45,343	(41.0)%	76,836	11.4%	68,999
Provision for income taxes	27,293	(11.6)%	30,882	10.8%	27,867
Net income	$ 18,050	(60.7)%	$ 45,954	11.7%	$ 41,132

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

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The following table sets forth the Consolidated Statements of Operations, expressed as a percentage of net revenue, for the periods presented:

	Year Ended December 31,		
	2008	2007	2006
Net revenue	100%	100%	100%
Cost of revenue	67.6	66.7	66.2
Gross margin	32.4	33.3	33.8
Operating expenses:			
Research and development	4.5	3.9	3.2
Sales and marketing	16.4	16.2	16.0
General and administrative	4.3	3.7	3.7
Restructuring	0.3	0.0	0.0
In-process research and development	0.2	0.6	0.5
Litigation reserves, net	0.1	0.0	0.0
Total operating expenses	25.8	24.4	23.4
Income from operations	6.6	8.9	10.4
Interest income, net	0.6	1.2	1.2
Other income (expense), net	(1.1)	0.5	0.4
Income before income taxes	6.1	10.6	12.0
Provision for income taxes	3.7	4.3	4.8
Net income	2.4%	6.3%	7.2%

Net Revenue

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
Net revenue	$ 743,344	2.1%	$ 727,787	26.9%	$ 573,570

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.

2008 Net Revenue Compared to 2007 Net Revenue

Net revenue increased $15.5 million, or 2.1%, to $743.3 million for the year ended December 31, 2008, from $727.8 million for the year ended December 31, 2007. We experienced lower net revenue in the second half of the year due to the economic downturn and the rapid strengthening of the U.S. dollar. The increase in total year revenue was attributable to higher sales in several of our product categories. These include wireless-G products sold to existing service provider customers and the full year sales of our ReadyNAS products, which were acquired in connection with our acquisition of Infrant in May 2007, as well as growth in wireless-N router sales. The growth was partially offset by a decrease in DSL gateway products sold.

Sales incentives that are classified as contra-revenue grew at a slower rate than overall gross sales, which further contributed to the increased net revenue.

For the year ended December 31, 2008 revenue generated in the United States, EMEA and Asia Pacific and rest of world was 40.1%, 47.6% and 12.3%, respectively. The comparable net revenue for the year ended December 31, 2007 was 37.6%, 52.3% and 10.1%, respectively. The change in net revenue over the prior year for each region amounted to an 8.7% increase, a 6.9% decrease, and a 24.3% increase, respectively.

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2007 Net Revenue Compared to 2006 Net Revenue

Net revenue increased $154.2 million, or 26.9%, to $727.8 million for the year ended December 31, 2007, from $573.6 million for the year ended December 31, 2006. We continued to experience our seasonal pattern of higher net revenues in the second half of the year. The increase in revenue was attributable to higher sales in several of our product categories. These include DSL gateway and cable gateway products sold to new and existing service provider customers and stronger worldwide switch sales, the launch of our ReadyNAS products, which were acquired in connection with our acquisition of Infrant, and a full year of wireless-N router sales.

Sales incentives that are classified as contra-revenue grew at a slower rate than overall gross sales, which further contributed to the increased net revenue. This favorable net revenue impact was partially offset by an increase in sales returns compared to historical return rates.

For the year ended December 31, 2007 revenue generated in the United States, EMEA and Asia Pacific and rest of world was 37.6%, 52.3% and 10.1%, respectively. The comparable net revenue for the year ended December 31, 2006 was 38.4%, 52.0% and 9.6%, respectively. The increase in net revenue over the prior year for each region was 24.2%, 27.5% and 34.3%, respectively.

Cost of Revenue and Gross Margin

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
Cost of revenue	$ 502,320	3.5%	$ 485,180	27.7%	$ 379,911
Gross margin percentage	32.4%		33.3%		33.8%

Cost of revenue consists primarily of the following: the cost of finished products from our third party manufacturers; overhead costs including purchasing, product planning, inventory control, warehousing and distribution logistics; inbound freight; warranty costs associated with returned goods; write-downs for excess and obsolete inventory; and amortization expense of certain acquired intangibles. We outsource our manufacturing, warehousing and distribution logistics. We believe this outsourcing strategy allows us to better manage our product costs and gross margin. Our gross margin can be affected by a number of factors, including fluctuation in foreign exchange rates, 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.

2008 Cost of Revenue and Gross Margin Compared to 2007 Cost of Revenue and Gross Margin

Cost of revenue increased $17.1 million, or 3.5%, to $502.3 million for the year ended December 31, 2008, from $485.2 million for the year ended December 31, 2007. Our gross margin decreased to 32.4% for the year ended December 31, 2008, from 33.3% for the year ended December 31, 2007.

The decrease in gross margin was primarily attributable to sales of products carrying lower gross margins to service providers and the impact on our foreign currency denominated revenues due to the strengthening of the U.S. dollar, as well as higher warranty costs associated with end-user warranty returns. Additionally, inventory reserves increased primarily due to selling price declines of certain products. These declines were primarily attributable to the strengthening of the U.S. dollar in locations where we bill in local currencies. These negative margin impacts were partially mitigated by reduced air freight expenses as a result of increased on-hand inventory levels which allowed us to minimize the amount of higher cost air freight expense, as well as reduced marketing expenses.

Additionally, stock-based compensation expense increased $231,000 to $864,000 for the year ended December 31, 2008, from $633,000 for the year ended December 31, 2007.

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2007 Cost of Revenue and Gross Margin Compared to 2006 Cost of Revenue and Gross Margin

Cost of revenue increased $105.3 million, or 27.7%, to $485.2 million for the year ended December 31, 2007, from $379.9 million for the year ended December 31, 2006. Our gross margin decreased to 33.3% for the year ended December 31, 2007, from 33.8% for the year ended December 31, 2006.

The decrease in gross margin percentage was primarily attributable to higher warranty costs associated with end-user warranty returns as well as amortization expense related to certain intangible assets acquired in connection with the Infrant acquisition. We amortized an additional $3.1 million in intangibles related to our recent acquisitions in the year ended December 31, 2007 as compared to the year ended December 31, 2006. We also sold through the entire $3.5 million in inventory acquired from Infrant, which was recorded at fair value under purchase accounting guidelines. Of this $3.5 million, $1.3 million represented a charge for the step-up to fair value in connection with the acquisition purchase accounting. We also experienced increased sales of products carrying lower gross margins to service providers.

These negative margin impacts were partially mitigated by certain gross margin improvements. Our gross margin was impacted by our sales incentives that are recorded as a reduction in revenue which grew at a relatively slower rate than overall net revenue. We experienced decreased price protection claims, as well as relatively lower inbound freight during the year, as we were able to continue to shift the mix of inbound shipments from our suppliers from more costly air freight to lower cost sea freight due to better supply chain planning.

Additionally, stock-based compensation expense increased $203,000 to $633,000 for the year ended December 31, 2007, from $430,000 for the year ended December 31, 2006.

Operating Expenses

Research and Development Expense

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
Research and development expense	$ 33,773	20.3%	$ 28,070	52.2%	$ 18,443
Percentage of net revenue	4.5%		3.9%		3.2%

Research and development expenses consist primarily of personnel expenses, payments to suppliers for design services, safety and regulatory testing, product certification expenditures to qualify our products for sale into specific markets, prototypes and other consulting fees. Research and development expenses are recognized as they are incurred. We have invested in building our research and development organization to enhance our ability to introduce innovative and easy to use products. In the future, we believe that research and development expenses will increase in absolute dollars as we expand into new networking product technologies and broaden our core competencies.

2008 Research and Development Expense Compared to 2007 Research and Development Expense

Research and development expenses increased $5.7 million, or 20.3%, to $33.8 million for the year ended December 31, 2008, from $28.1 million for the year ended December 31, 2007. The increase was primarily due to increased salary, related payroll and other employee expenses of $3.6 million primarily due to incremental headcount expenses related to the acquisition of Infrant in May 2007, which was partially offset by a decrease in employee performance compensation of $1.7 million. Employee headcount increased by 37% to 158 employees as of December 31, 2008 as compared to 115 employees as of December 31, 2007, primarily due to new employees obtained from the acquisition of certain assets of CP Secure International Holding Limited (CP Secure) in December 2008. The increase in research and development expense was also due to an increase in non-recurring engineering of $1.3 million primarily due to incremental product development projects, as well as an increase in costs allocated to research and development from other functional expense categories of $1.4 million primarily resulting from increased facilities costs primarily related to our new corporate headquarters in San Jose, California. Additionally, stock-based compensation expense increased $827,000 to $3.2 million for the year ended December 31, 2008, from $2.4 million for the year ended December 31, 2007.

2007 Research and Development Expense Compared to 2006 Research and Development Expense

Research and development expenses increased $9.7 million, or 52.2%, to $28.1 million for the year ended December 31, 2007, from $18.4 million for the year ended December 31, 2006. The increase was primarily due to higher salary and related payroll expenses of $4.8 million resulting from research and development headcount growth, including $292,000 of retention bonuses for certain employees associated with the acquisition of SkipJam Corp. (SkipJam) and $1.7 million related to higher headcount from the Infrant acquisition. Employee headcount increased by 85% to 115 employees as of December 31, 2007 as compared to 62 employees as of December 31, 2006, in part due to 26 employees obtained from the acquisition of Infrant. Other employee expenses increased by $800,000 due to contractor conversions in our China Engineering Center and recruiting costs. Rent expense increased $643,000 due to the expansion of our China Engineering Center. Furthermore, information technology infrastructure costs allocated to research and development increased $982,000 as a result of additional investments in software and systems in 2007 as well as relatively higher headcount which drove a higher allocation percentage to research and development. Additionally, stock-based compensation expense increased $1.3 million to $2.4 million for the year ended December 31, 2007, from $1.1 million for the year ended December 31, 2006.

Sales and Marketing Expense

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
Sales and marketing expense	$ 121,687	3.2%	$ 117,938	28.4%	$ 91,881
Percentage of net revenue	16.4%		16.2%		16.0%

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. In 2009 we believe sales and marketing expense will decrease as we implement cost savings efforts.

2008 Sales and Marketing Expense Compared to 2007 Sales and Marketing Expense

Sales and marketing expenses increased $3.8 million, or 3.2%, to $121.7 million for the year ended December 31, 2008, from $117.9 million for the year ended December 31, 2007. Of this increase, $2.8 million was attributable to increased salary, related payroll and other employee expenses as a result of sales and marketing related headcount growth, which was partially offset by a decrease in employee performance compensation of $1.7 million. Employee headcount increased from 260 employees as of December 31, 2007 to 266 employees as of December 31, 2008. Most of our increase in headcount occurred in connection with our expansion in EMEA and Asia Pacific. Furthermore, outbound freight increased $1.0 million, reflecting our higher unit volume sales, and costs allocated to sales and marketing from other functional expense categories increased $1.8 million due to increased facilities costs primarily related to our new corporate headquarters in San Jose, California. These increases were partially offset by lower advertising and promotion expenses.

2007 Sales and Marketing Expense Compared to 2006 Sales and Marketing Expense

Sales and marketing expenses increased $26.0 million, or 28.4%, to $117.9 million for the year ended December 31, 2007, from $91.9 million for the year ended December 31, 2006. Of this increase, $9.7 million was due to increased salary and payroll related expenses, including sales commissions, as a result of sales and marketing related headcount growth and increased commissions due to the revenue growth. Employee headcount increased from 207 employees as of December 31, 2006 to 260 employees as of December 31, 2007. More specifically, 47 of the 53 incremental employees related to expansion in EMEA and Asia Pacific. Outside service fees related to customer service and technical support increased by $3.8 million, in support of higher call volumes. We also incurred a $1.9 million increase in advertising and promotion expenses related to our expansion of marketing activities into new geographic regions. Outbound freight increased $3.2 million, reflecting our higher sales volume. Travel and entertainment increased $1.7 million and rent increased by $873,000 due to the higher headcount and expansion into new countries. Marketing costs classified as operating expenses remained relatively constant, as the majority of incremental marketing expenses related to rebates and other items classified as contra-revenue. Furthermore, information technology infrastructure costs allocated to sales and marketing increased $1.9 million as a result of additional investments in software and systems in 2007 as well as relatively higher headcount which drove a higher allocation percentage to sales and marketing. Additionally, stock-based compensation expense increased $1.6 million to $3.0 million for the year ended December 31, 2007, from $1.4 million for the year ended December 31, 2006.

General and Administrative Expense

	Year Ended December 31,				
	2008	Percentage Change	2007	Percentage Change	2006
	(In thousands, except percentage data)				
General and administrative expense	$ 31,733	16.6%	$ 27,220	30.2%	$ 20,905
Percentage of net revenue	4.3%		3.7%		3.7%

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. In 2009 we expect general and administrative costs to increase slightly as compared to the year ended December 31, 2008.

2008 General and Administrative Expense Compared to 2007 General and Administrative Expense

General and administrative expenses increased $4.5 million, or 16.6%, to $31.7 million for the year ended December 31, 2008, from $27.2 million for the year ended December 31, 2007. The increase was primarily due to higher outside professional services, due to higher legal consulting expenses of $3.5 million. Furthermore, stock-based compensation expense increased approximately $1.0 million to $3.8 million for the year ended December 31, 2008, from $2.8 million for the year ended December 31, 2007. Overall general and administrative compensation costs were flat, as the increases in salary, related payroll and other employee expenses were offset by a decrease in employee performance compensation.

2007 General and Administrative Expense Compared to 2006 General and Administrative Expense

General and administrative expenses increased $6.3 million, or 30.2%, to $27.2 million for the year ended December 31, 2007, from $20.9 million for the year ended December 31, 2006. Employee headcount increased by 17% to 77 employees as of December 31, 2007 compared to 66 employees as of December 31, 2006. We also incurred a $3.1 million increase in fees for outside professional services, due to higher accounting, tax, legal and IT consulting expenses. Software and hardware maintenance increased by $644,000 primarily due to our new enterprise resource planning system. We experienced an increase in depreciation expense of $731,000 as compared to the previous year due to the continued investment in our finance and operations systems. Additionally, stock-based compensation expense increased approximately $1.2 million to $2.8 million for the year ended December 31, 2007, from $1.6 million for the year ended December 31, 2006. Offsetting these increases were higher IT and facilities allocations to research and development as well as sales and marketing due to relatively higher headcount growth in those areas.

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Restructuring

During the year ended December 31, 2008, we expensed $965,000 related to the termination of employment of approximately 35 individuals on November 12, 2008. Additionally, we expensed $964,000 related to excess facilities we ceased to use in Santa Clara and Fremont, California due to our relocation to a new corporate headquarters in San Jose, California. For a detailed discussion of our restructuring expenses, please see Note 4 of the Notes to Consolidated Financial Statements.

We did not incur any restructuring expense during the year ended December 31, 2007 or 2006.

In-process Research and Development

During the year ended December 31, 2008, we expensed $1.8 million for in-process research and development (in-process R&D) related to intangible assets purchased in our acquisition of certain assets of CP Secure. See Note 2 of the Notes to Consolidated Financial Statements for additional information regarding this acquisition. The in-process R&D was expensed upon acquisition because technological feasibility had not been established and no future alternative uses exist. We acquired two in-process R&D projects, both of which involved improvements to threat management characteristics of future products.

To date, there have been no significant differences between the actual and estimated results of the in-process R&D projects. We estimate that we will incur costs of approximately $870,000 to complete the projects, of which approximately $120,000 was incurred through December 31, 2008. We expect to complete and begin benefiting from these projects in mid-2009.

During the year ended December 31, 2007, we expensed $4.1 million for in-process R&D related to intangible assets purchased in our acquisition of Infrant. The in-process R&D was expensed upon acquisition because technological feasibility had not been established and no future alternative uses exist. We acquired three in-process R&D projects. Two projects involve development of new products in the ReadyNAS desktop product category, and one project involves development of a higher end version of a product currently selling in the ReadyNAS rack mount product category. We expect to incur costs of approximately $1.6 million to complete the projects, of which approximately $1.4 million was incurred through December 31, 2008. We completed two projects in mid-2008, and we expect to complete and begin benefiting from the final project contemplated at the date of acquisition in the middle of the year ending December 31, 2009.

During the year ended December 31, 2006, we expensed $2.9 million for in-process R&D related to intangible assets purchased in our acquisition of SkipJam. The in-process R&D was expensed upon acquisition because technological feasibility has not been established and no future alternative uses exist. We acquired only one in-process R&D project, which is related to the development of a multimedia product that had not reached technological feasibility and had no alternative use. We incurred costs of approximately $725,000 to complete the project, of which approximately $575,000 was incurred through December 31, 2006 and an additional $150,000 was incurred during the year ended December 31, 2007. We completed the project in February 2007.

Litigation Reserves and Payments

During the year ended December 31, 2008, we recorded net litigation reserves expense of $711,000. This expense was primarily comprised of $575,000 in estimated costs related to the settlement of various lawsuits filed against us. Additionally, we incurred $109,000 for costs related to the settlement of the patent-infringement lawsuit filed by Hybrid Patents, Inc. (Hybrid) against Charter Communications, Inc. (Charter) where we assumed the defense of the litigation after receiving a request for indemnification from Charter and an expense of $85,000 for costs related to the settlement of the patent-infringement lawsuit filed by Linex Technologies, Inc. against us. These expenses were offset by a reduction in previously accrued legal settlement costs of $58,000. For a detailed discussion of our litigation matters, please see Note 8 of the Notes to Consolidated Financial Statements.

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During the year ended December 31, 2007, we recorded an expense of $167,000 for costs related to the settlement of the *SercoNet v. NETGEAR* lawsuit. There were no litigation reserves recorded in the year ended December 31, 2006.

Interest Income and Other Income (Expense)

	Year Ended December 31,		
	2008	2007	2006
	(In thousands)		
Interest income and other income (expense)			
Interest income, net	$ 4,336	$ 8,426	$ 6,974
Other income (expense), net	(8,384)	3,298	2,495
Total interest income and other income (expense)	$ (4,048)	$ 11,724	$ 9,469

Interest income represents amounts earned on our cash, cash equivalents and short-term investments.

Other income (expense), net, primarily represents gains and losses on transactions denominated in foreign currencies and other miscellaneous expenses.

2008 Interest Income and Other Income (Expense) Compared to 2007 Interest Income and Other Income (Expense)

The aggregate of interest income, interest expense, other income, and other expense amounted to net other expense of $4.0 million for the year ended December 31, 2008, compared to net other income of $11.7 million for the year ended December 31, 2007. The decrease is partially due to a $4.1 million decrease in interest income, which is a result of a decrease in interest rates on our cash, cash equivalents, and short-term investments balances during the year. We also recorded a net foreign exchange loss of $8.4 million due to the continued strengthening of the U.S. dollar against the euro, the British pound, the Australian dollar and the Japanese yen during 2008, which was a reversal of the weakening U.S. dollar trend experienced in 2007.

2007 Interest Income and Other Income (Expense) Compared to 2006 Interest Income and Other Income (Expense)

The aggregate of interest income, interest expense, other income, and other expense amounted to net other income of $11.7 million for the year ended December 31, 2007, compared to $9.5 million for the year ended December 31, 2006. The increase is partially due to a $1.4 million increase in interest income, which is a result of our increased cash balances. The interest rate we earned on our cash balances decreased during the year. Other income (expense), net, increased by $803,000. The net foreign exchange gain of $3.3 million was due to the continued weakening of the U.S. dollar against the euro, the British pound, the Australian dollar and the Japanese yen during 2007.

Provision for Income Taxes

2008 Provision for Income Taxes Compared to 2007 Provision for Income Taxes

Provision for income taxes decreased $3.6 million, resulting in a provision of $27.3 million for the year ended December 31, 2008, compared to a provision of $30.9 million for the year ended December 31, 2007. The effective tax rate increased from 40.2% for the year ended December 31, 2007 to 60.2% for the year ended December 31, 2008. The effective tax rate for both periods differed from the statutory rate of approximately 35% due to non-deductible stock-based compensation, state taxes, other non-deductible expenses, and tax credits. In 2008, there was no rate effect from in-process R&D expensed in connection with the acquisition of CP Secure since such in-process R&D was deductible for tax purposes. In 2007, the acquisition of Infrant resulted in non-deductible in-process R&D expense which resulted in an increase in the effective tax rate. Additionally, in 2008 compared to 2007, tax attributable to foreign operations increased the effective tax rate by 19.4 percentage points. This was primarily caused by the tax effect of non-deductible losses in foreign jurisdictions where no benefit can be claimed and increases in earnings in countries with rates higher than 35%.

2007 Provision for Income Taxes Compared to 2006 Provision for Income Taxes

Provision for income taxes increased $3.0 million, resulting in a provision of $30.9 million for the year ended December 31, 2007, from a provision of $27.9 million for the year ended December 31, 2006. The effective tax rate remained unchanged and was approximately 40% for the years ended December 31, 2007 and December 31, 2006. The effective tax rate for both periods differed from our statutory rate of approximately 35% due to non-deductible stock-based compensation, non-deductible charges pertaining to in-process research and development as a result of our recent acquisitions, state taxes, other non-deductible expenses, and tax credits.

Net Income

Net income decreased $27.9 million, or 60.7%, to $18.1 million for the year ended December 31, 2008, from $46.0 million for the year ended December 31, 2007. This decrease was primarily attributable to an increase in operating expenses of $14.1 million, a decrease in other income (expense), net, of $11.7 million, and a decrease in interest income, net, of $4.1 million. These decreases in pre-tax income were offset by a decrease in provision for income taxes of $3.6 million.

Net income increased $4.9 million, or 11.7%, to $46.0 million for the year ended December 31, 2007, from $41.1 million for the year ended December 31, 2006. This increase was primarily attributable to an increase in gross profit of $48.9 million, an increase in interest income of $1.4 million and an increase in other income of $803,000. These increases were partially offset by an increase in operating expenses of $43.4 million and an increase in the provision for income taxes of $3.0 million.

Liquidity and Capital Resources

As of December 31, 2008 we had cash, cash equivalents and short-term investments totaling $203.0 million.

Our cash and cash equivalents balance increased from $167.5 million as of December 31, 2007 to $192.8 million as of December 31, 2008. Our short-term investments, which represent the investment of funds available for current operations, decreased from $37.8 million as of December 31, 2007 to $10.2 million as of December 31, 2008, as we shifted assets from Treasuries to low risk money market funds with higher returns. Operating activities during the year ended December 31, 2008 generated cash of $47.5 million. Investing activities during the year ended December 31, 2008 used $12.5 million, which includes the net proceeds from the sale of short-term investments of $27.5 million, offset primarily by payments, excluding cash acquired, made in connection with the acquisitions of Infrant and certain assets of CP Secure of $24.6 million, and purchases of property and equipment amounting to $15.4 million. During the year ended December 31, 2008, financing activities used $9.7 million, due to the repurchase and retirement of 1.2 million shares of our common stock for $12.2 million offset in part by the issuance of our common stock upon exercise of stock options and our employee stock purchase program, as well as the excess tax benefit from exercise of stock options.

Our days sales outstanding increased from 73 days as of December 31, 2007 to 81 days as of December 31, 2008.

Our accounts payable increased from $55.3 million at December 31, 2007 to $60.1 million at December 31, 2008 primarily as a result of inventory growth and timing of payments.

Inventory increased by $29.2 million from $83.0 million at December 31, 2007 to $112.2 million at December 31, 2008 in part due to a decline in sales. Ending inventory turns decreased from 6.5 turns in the quarter ended December 31, 2007, to 4.0 turns in the quarter ended December 31, 2008.

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We enter into foreign currency forward-exchange contracts, which typically mature in three months, to hedge a portion of our exposure to foreign currency fluctuations of foreign currency-denominated receivables, payables, and cash balances. We record on the consolidated balance sheet at each reporting period the fair value of our forward-exchange contracts and record any fair value adjustments in our Consolidated Statements of Operations. Gains and losses associated with currency rate changes on contracts are recorded within other income (expense), net, offsetting gains and losses on our monetary assets and liabilities.

On October 21, 2008, the Board of Directors approved plans to purchase shares of our common stock in the open market. During the year ended December 31, 2008, we purchased approximately 1.2 million shares of our common stock in the open market for cash of $12.2 million. As of December 31, 2008, we were authorized to purchase up to an additional 4.8 million shares under the share repurchase plan. See Note 9 of the Notes to Consolidated Financial Statements for a discussion of the accounting for our common stock repurchases. The stock repurchase authorization does not have an expiration date and the pace of repurchase activity will depend on various factors including, but not limited to, such factors as levels of cash generation from operations, cash requirements for acquisitions, and current stock price.

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 the foreseeable future. However, we cannot be certain that our planned levels of revenue, costs and expenses will be achieved. If our operating results fail to meet our expectations or if we fail to manage our inventory, accounts receivable or other assets, we could be required to seek additional funding through public or private financings or other arrangements. In addition, as we continue to expand our product offerings, channels and geographic presence, we may require additional working capital. In such event, adequate funds may not be available when needed or may not be available on favorable or commercially acceptable terms, which could have a negative effect on our business and results of operations.

Backlog

As of December 31, 2008, we had a backlog of approximately $37.7 million compared to approximately $37.8 million as of December 31, 2007. Our backlog consists of products for which customer purchase orders have been received and which are scheduled or in the process of being scheduled for shipment. While we expect to fulfill the order backlog within the current year, most orders are subject to rescheduling or cancellation with little or no penalties. Because of the possibility of customer changes in product scheduling or order cancellation, our backlog as of any particular date may not be an indicator of net sales for any succeeding period.

Contractual Obligations and Off-Balance Sheet Arrangements

Contractual Obligations

The following table describes our commitments to settle non-cancelable lease and purchase commitments as of December 31, 2008.

	Less Than 1 Year	1-3 Years	3-5 Years (In thousands)	More Than 5 Years	Total
Operating leases, net of sublease payments	$ 5,589	$ 7,922	$ 16,716	$ 6,176	$ 36,403
Purchase obligations	$ 26,777	$	$	$	$ 26,777
	$ 32,366	$ 7,922	$ 16,716	$ 6,176	$ 63,180

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense was $6.3 million for the year ended December 31, 2008, $3.4 million for the year ended December 31, 2007, and $2.2 million for the year ended December 31, 2006. The terms of some of the office leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period, and have accrued for rent expense incurred but not paid. We have also accrued for the expected loss on certain facilities we do not intend to sublease. The amounts presented are consistent with contractual terms and are not expected to differ significantly, unless a substantial change in our headcount needs requires us to exit an office facility early or expand our occupied space.

We enter into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of the orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31-45 days prior to the expected shipment date. Orders are not cancelable within 30 days prior to the expected shipment date. At December 31, 2008, we had $26.8 million in non-cancelable purchase commitments with suppliers. We expect to sell all products for which we have committed purchases from suppliers.

We adopted FIN 48 on January 1, 2007. As of December 31, 2008 and December 31, 2007, we had $14.5 million and $10.0 million, respectively, of total gross unrecognized tax benefits and related interest. The timing of any payments which could result from these unrecognized tax benefits will depend upon a number of factors. Accordingly, the timing of payment cannot be estimated. We do not expect a significant tax payment related to these obligations to occur within the next 12 months.

Off-Balance Sheet Arrangements

As of December 31, 2008, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Recent Accounting Pronouncements

See Note 1 of the Notes to Consolidated Financial Statements for recent accounting pronouncements, which are hereby incorporated by reference into this Part II, Item 7.

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

Interest Rate Risk

We do not use derivative financial instruments in our investment portfolio. We have an investment portfolio of fixed income securities that are classified as available-for-sale securities. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in highly rated short-term securities. Additionally, our investment policy generally limits the amount of credit exposure to any one issuer. Our investment policy requires investments to be rated triple-A with the objective of minimizing the potential risk of principal loss. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% by market interest rates would not have a material impact on our operating results and the total value of the portfolio over the next fiscal year. We monitor our interest rate and credit risks, including our credit exposure to specific rating categories and to individual issuers. There were no impairment charges on our investments during fiscal 2008.

Foreign Currency Transaction Risk

In the second quarter of 2005 we began to invoice some of our international customers in foreign currencies including, but not limited to, the Australian dollar, British pound, euro, and Japanese yen. As the customers that are currently invoiced in local currency become a larger percentage of our business, or to the extent we begin to bill additional customers in foreign currencies, the impact of fluctuations in foreign exchange rates could have a more significant impact on our results of operations. For those customers in our international markets that we continue to sell to in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand for our products could reduce sales and negatively impact our operating results. Certain operating expenses of our foreign operations require payment in the local currencies.

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We are exposed to risks associated with foreign exchange rate fluctuations due to our international sales and operating activities. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. We began using derivatives in the fourth quarter of 2008 to partially offset our business exposure to foreign exchange risk on our foreign currency denominated assets and liabilities. The objective of these contracts is to reduce the impact of currency exchange rate movements on our operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The contracts are marked-to-market on a monthly basis with gains and losses included in other income (expense), net in the Consolidated Statements of Operations. We do not use foreign currency contracts for speculative or trading purposes. Hedging of our balance sheet exposures may not always be effective to protect us against currency exchange rate fluctuations. In addition, we do not fully hedge our balance sheet exposures, leaving us at risk to foreign exchange gains and losses on the unhedged exposures. Furthermore, our hedging program is not currently structured to reduce the impact, due to volatile exchange rates, on net revenues, gross profit and operating profit. Accordingly, if there was an adverse movement in exchange rates, we might suffer significant losses. See Note 3 of the Notes to Consolidated Financial Statements for additional disclosure on our foreign currency contracts, which are hereby incorporated by reference into this Part II, Item 7A.

As of December 31, 2008, we had net assets in various local currencies. A hypothetical 10% movement in foreign exchange rates would result in an after tax positive or negative impact of $98,000 to net income, net of our hedged position, at December 31, 2008. Actual future gains and losses associated with our foreign currency exposures and positions may differ materially from the sensitivity analyses performed as of December 31, 2008 due to the inherent limitations associated with predicting the foreign currency exchange rates, and our actual exposures and positions. For the year ended December 31, 2008, 30% of total net revenue was denominated in a currency other than the U.S. dollar.

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Item 8. ***Consolidated Financial Statements and Supplementary Data***

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

of NETGEAR, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15 (a)(1) present fairly, in all material respects, the financial position of NETGEAR, Inc. and its subsidiaries at December 31, 2008 and December 31, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule appearing under Item 15 (a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 of the Notes to Consolidated Financial Statements, the Company changed the manner in which it accounts for fair value measurement of financial assets and liabilities in 2008 and the manner in which it accounts for uncertain tax positions in 2007.

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

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

/s/ PricewaterhouseCoopers LLP

San Jose, California

March 3, 2009

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NETGEAR, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 192,839	$ 167,495
Short-term investments	10,170	37,848
Accounts receivable, net	138,275	157,765
Inventories	112,240	83,023
Deferred income taxes	13,129	13,091
Prepaid expenses and other current assets	22,695	20,367
Total current assets	489,348	479,589
Property and equipment, net	20,292	11,205
Intangibles, net	13,311	16,319
Goodwill	61,400	41,985
Other non-current assets	1,858	2,011
Total assets	$ 586,209	$ 551,109
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 60,073	$ 55,333
Accrued employee compensation	7,177	16,085
Other accrued liabilities	87,747	89,470
Deferred revenue	21,508	7,619
Total current liabilities	176,505	168,507
Deferred income tax liability	15	2,626
Non-current income taxes payable	12,357	8,272
Other non-current liabilities	6,374	181
Total liabilities	195,251	179,586
Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred stock: $0.001 par value; 5,000,000 shares authorized in 2008 and 2007; none outstanding in 2008 or 2007		
Common stock: $0.001 par value; 200,000,000 shares authorized in 2008 and 2007; shares issued and outstanding: 34,280,539 in 2008 and 35,243,586 in 2007	34	35
Additional paid-in capital	266,070	252,421
Cumulative other comprehensive income	67	101
Retained earnings	124,787	118,966
Total stockholders equity	390,958	371,523
Total liabilities and stockholders equity	$ 586,209	$ 551,109

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

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NETGEAR, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,		
	2008	2007	2006
Net revenue	$ 743,344	$ 727,787	$ 573,570
Cost of revenue	502,320	485,180	