NETGEAR Reports Third Quarter 2004 Results

- Third quarter 2004 net revenue increased to $101.2 million, 34% year-over-year growth
- Third quarter 2004 non-GAAP net income increased to $6.3 million, as compared to $2.4 million in the comparable prior year quarter, 163% year over year growth
- Third quarter 2004 non-GAAP diluted EPS of $0.20, as compared to $0.08 in the comparable prior year quarter, 150% year-over-year growth.
- Third quarter 2004 non-GAAP operating margin increased to 9.8%, with gross margin at 32.1%
- Company expects fourth quarter 2004 net revenue to be in the range of $107 million to $109 million, with non-GAAP operating margin in the range of 9.9% to 10.2%


Net revenue for the third quarter ended October 3, 2004 was $101.2 million, a 34% increase as compared to $75.8 million for the third quarter ended September 28, 2003. Net revenue for the second quarter of 2004 was $88.4 million. Net revenue in the third quarter of 2004 derived from North America was $57.1 million, the Europe, Middle East and Africa, or EMEA, region was $36.2 million, and the Asia Pacific region was $8.0 million. There were 14 weeks in the third quarter of 2004 as compared to 13 weeks in the second quarter of 2004 and the third quarter of 2003.

The Company improved its gross margin in the third quarter of 2004 to 32.1%, as compared to 27.8% in the year ago comparable quarter, and 32.1% in the prior quarter. Non-GAAP operating margin was 9.8% in the third quarter of 2004, as compared to 5.6% in the year ago comparable quarter and 8.9% in the prior quarter. In the third quarter of 2004, non-GAAP operating expenses were 22.3% of net revenue, as compared to 22.2% in the year ago comparable quarter and 23.2% in the prior quarter. Sales and marketing, research and development and general and administration expenses as a percentage of net revenues were 15.2%, 2.7% and 4.4%, as compared with 16.4%, 2.7% and 3.1% in the year ago comparable quarter, and 17.0%, 2.6% and 3.6% in the prior quarter.

Net income, computed in accordance with GAAP, for the third quarter of 2004 was $5.9 million or $0.19 per basic share and $0.18 per diluted share, compared to a net loss of $(4.0) million for the third quarter of 2003 or $(0.15) per basic and diluted share. Included in net income for the prior year quarter was an extinguishment of debt charge of $5.9 million and non-cash stock-based compensation expense of $516,000.

Non-GAAP net income, which excludes non-cash, stock-based compensation expense of $452,000, for the third quarter of 2004 was $6.3 million, a 163% increase over the non-GAAP net income of $2.4 million for the third quarter of 2003. Non-GAAP net income per share was $0.21 per basic share and $0.20 per diluted share in the third quarter of 2004, compared to $0.09 per basic share and $0.08 per diluted share in the third quarter of 2003. The non-GAAP net income for the third quarter of 2003 excludes the impact of an extinguishment of debt charge of $5.9 million and non-cash stock-based compensation expense of $516,000. The accompanying schedules provide a reconciliation of net income computed on a GAAP basis to net income computed on a non-GAAP basis.

Patrick Lo, Chairman and Chief Executive Officer of NETGEAR, commented, “This was another impressive quarter for us. On a year over year basis, sales in North America were up 24%, with the EMEA region up 49% and the Asia Pacific region up 48%. On a quarterly sequential basis, North America was up 23%, EMEA was up 11% and Asia Pacific declined 14% due to traditional seasonality in that geographic market. Demand remained strong in nearly all market segments, with strong consumer demand highlighted by robust back to school sales in the U.S. and the continued adoption of wireless products. We are also pleased with the traction we are gaining in the worldwide service provider channel, which has increased to 7% of our total revenue. During the third quarter, we added Charter Communications to our growing list of major service provider customers. We continue to expect that NETGEAR will experience better than average industry growth as many of our recently introduced products gain sales traction. For example, during the last few months we announced new relationships with Vonage and AT&T for our broadband telephony products. While the market is in the early adoption phase, we expect businesses and consumers will adopt Voice over IP (VoIP) technologies in increasing numbers going forward given the lower cost and higher flexibility of this technology. In addition, we are excited about our VoIP prospects for international markets, as we commenced shipping products into these markets in the third quarter.”

Jonathan Mather, Chief Financial Officer of NETGEAR, said, “Our continued strong operating performance reflects our focus on operating metrics, including inventory management, timely shipments and cost containment. Our gross margin of...
32.1% was consistent with the prior quarter, and up substantially from the comparable year ago quarter, while our non-GAAP operating margin increased to 9.8%, as compared with 8.9% in the prior quarter. The operating expenses as a percentage of net revenue have declined to 22.3% despite additional G&A costs associated with Sarbanes-Oxley 404 compliance. Importantly, NETGEAR's cash on hand, including short-term investments, increased to $118.6 million at the end of the third quarter of 2004 from $111.2 million at the end of the second quarter of 2004, primarily due to cash generated from operating activities."

Third quarter 2004 ending inventory was $40.5 million, representing 6.8 turns, compared to $44.2 million and 5.4 turns at the end of the second quarter of 2004. Days sales outstanding (DSO's) was 71 days in the third quarter of 2004, compared to 69 days in the second quarter of 2004. The U.S. retail channel inventory ended the third quarter of 2004 at 7.1 weeks, as compared to 9.2 weeks in the second quarter of 2004. U.S. distribution channel inventory ended the third quarter of 2004 at 3.9 weeks, as compared to 4.3 weeks in the second quarter of 2004. European distribution channel inventory ended the third quarter of 2004 at approximately 4.2 weeks compared to 4.4 weeks in the second quarter of 2004.

Looking forward, Mr. Lo added, "Our third quarter was strong as we shipped a record number of units of our products while continuing to improve our operating performance. We believe the fourth quarter should be even better due to normal industry seasonality and our new product roadmap. With the 12 new products introduced in the third quarter and more scheduled product launches for the fourth quarter, we are targeting continued market share gains across all of our channels and geographies. We remain very aggressive in our channel expansion efforts worldwide. Based on industry reports, we expect our products supporting digital home entertainment, including our recently introduced Double 108 Mbps Wireless Router and Wireless Digital Music Player, to do well this holiday season. Other growth products include our DSL and cable broadband gateways, 108 Mbps wireless products, Smart Switches, Gigabit Switches, and our fully manageable switches. Overall, as we enter the seasonally stronger fourth quarter of 2004, we expect net revenue to be in the range of approximately $107 million to $109 million, with non-GAAP operating income in the range of 9.9% to 10.2%. Finally, we expect the non-GAAP effective tax rate to remain at approximately 37.0%.”

Investor Conference Call / Webcast Details

NETGEAR will review third quarter 2004 results and discuss management's expectations for the fourth quarter 2004 today, October 28, 2004, at 5:30PM EDT (2:30PM PDT). The conference call-in will be available at www.netgear.com and by telephone at (973) 582-2745. A replay will be available from 8:30PM EDT (5:30PM PDT) on October 28 through midnight EDT (9:00PM PDT) on November 4 by telephone at (973) 341-3080. The confirmation identification for both the live call and the replay is 5245601.

About NETGEAR Inc.

NETGEAR (Nasdaq: NTGR) designs technologically advanced, branded networking products that address the specific needs of small business and home users. The Company’s suite of approximately 100 products enables users to share Internet access, peripherals, files, digital multimedia content and applications among multiple personal computers and other Internet-enabled devices. NETGEAR is headquartered in Santa Clara, Calif. For more information, visit the Company's Web site at www.netgear.com or call (408) 907-8000.

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domestically and worldwide. These statements are based on management's current expectations and are subject to certain risks and uncertainties, including, without limitation, the following: future demand for the Company's products may be lower than anticipated; consumers may choose not to adopt the Company's new product offerings or adopt competing products; the Company may be unsuccessful or experience delays in the manufacturing and distributing of its new and existing products; telecommunications service providers may choose to utilize competing products; the Company may be unable to collect receivables as they become due; the Company may fail to manage costs, including the cost of developing new products and manufacturing and distribution of its existing offerings. Further information on potential risk factors that could affect NETGEAR and its business are detailed in the Company's periodic filings with the Securities and Exchange Commission, including, but not limited to, those risks and uncertainties listed in the section entitled "Risk Factors Affecting Future Results", pages 20 through 29, in the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 27, 2004, filed with the Securities and Exchange Commission on August 11, 2004. NETGEAR undertakes no obligation to release publicly any revisions to any forward-looking statements contained herein to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.