

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

(Mark One)

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

For the quarterly period ended September 27, 2020

☐ 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: 001-38618

ARLO TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

3030 Orchard Parkway

San Jose, California

(Address of principal executive offices)

38-4061754

(I.R.S. Employer Identification Number)

95134

(Zip Code)

(408) 890-3900

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value \$0.001 per share	ARLO	New York Stock Exchange

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large Accelerated filer	☐	Accelerated filer	☒
Non-Accelerated filer	☐	Smaller reporting company	☒
		Emerging growth company	☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The number of outstanding shares of the registrant's Common Stock, \$0.001 par value, was 79,037,169 as of October 23, 2020.

ARLO TECHNOLOGIES, INC.

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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements
ARLO TECHNOLOGIES, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	As of	
	September 27, 2020	December 31, 2019
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 173,619	\$ 236,680
Short-term investments (amortized cost of \$19,992 and \$19,967)	19,992	19,990
Accounts receivable (net of allowance for credit losses of \$509 and \$609)	56,431	127,317
Inventories	69,038	68,624
Prepaid expenses and other current assets	10,317	16,958
Total current assets	329,397	469,569
Property and equipment, net	16,832	21,352
Operating lease right-of-use assets, net	25,031	31,300
Intangibles, net	238	1,306
Goodwill	11,038	11,038
Restricted cash	4,147	4,139
Other non-current assets	2,216	4,008
Total assets	\$ 388,899	\$ 542,712
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 74,727	\$ 111,650
Deferred revenue	30,567	50,362
Accrued liabilities	106,027	127,400
Income tax payable	431	4,489
Total current liabilities	211,752	293,901
Non-current deferred revenue	7,963	15,736
Non-current operating lease liabilities	26,024	29,001
Non-current income taxes payable	92	92
Other non-current liabilities	1,261	606
Total liabilities	247,092	339,336
Commitments and contingencies (Note 10)		
Stockholders' Equity:		
Preferred stock: \$0.001 par value; 50,000,000 shares authorized; none issued or outstanding	—	—
Common stock: \$0.001 par value; 500,000,000 shares authorized; shares issued and outstanding: 79,026,508 at September 27, 2020 and 75,785,952 at December 31, 2019	79	76
Additional paid-in capital	359,297	334,821
Accumulated other comprehensive income	(9)	(2)
Accumulated deficit	(217,560)	(131,519)
Total stockholders' equity	141,807	203,376
Total liabilities and stockholders' equity	\$ 388,899	\$ 542,712

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

ARLO TECHNOLOGIES, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
(In thousands, except per share data)				
Revenue:				
Products	\$ 91,271	\$ 94,306	\$ 191,597	\$ 213,359
Services	18,965	11,810	50,721	34,235
Total revenue	110,236	106,116	242,318	247,594
Cost of revenue:				
Products	79,107	88,755	182,481	206,878
Services	9,720	6,858	28,986	18,618
Total cost of revenue	88,827	95,613	211,467	225,496
Gross profit	21,409	10,503	30,851	22,098
Operating expenses:				
Research and development	15,436	16,701	44,871	52,456
Sales and marketing	12,720	13,657	35,471	42,389
General and administrative	11,137	11,062	39,758	32,512
Separation expense	77	137	238	1,760
Gain on sale of business	—	—	(292)	—
Total operating expenses	39,370	41,557	120,046	129,117
Loss from operations	(17,961)	(31,054)	(89,195)	(107,019)
Interest income	74	596	760	2,170
Other income, net	543	154	2,837	138
Loss before income taxes	(17,344)	(30,304)	(85,598)	(104,711)
Provision for income taxes	115	286	443	855
Net loss	\$ (17,459)	\$ (30,590)	\$ (86,041)	\$ (105,566)
Net loss per share:				
Basic	\$ (0.22)	\$ (0.41)	\$ (1.11)	\$ (1.41)
Diluted	\$ (0.22)	\$ (0.41)	\$ (1.11)	\$ (1.41)
Weighted average shares used to compute net loss per share:				
Basic	78,662	75,337	77,705	74,831
Diluted	78,662	75,337	77,705	74,831

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

ARLO TECHNOLOGIES, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
	(In thousands)			
Net loss	\$ (17,459)	\$ (30,590)	\$ (86,041)	\$ (105,566)
Other comprehensive income (loss), before tax:				
Unrealized gain (loss) on derivative instruments	(9)	22	16	—
Unrealized gain (loss) on available-for-sale securities	(14)	(27)	(23)	46
Total other comprehensive income (loss), before tax	(23)	(5)	(7)	46
Tax benefit (provision) related to derivative instruments	—	—	—	—
Total other comprehensive income (loss), net of tax	(23)	(5)	(7)	46
Comprehensive loss	<u>\$ (17,482)</u>	<u>\$ (30,595)</u>	<u>\$ (86,048)</u>	<u>\$ (105,520)</u>

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

ARLO TECHNOLOGIES, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Common Stock						
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
(In thousands)						
Balance as of June 28, 2020	78,089	\$ 78	\$ 351,913	\$ 14	\$ (200,101)	\$ 151,904
Net loss	—	—	—	—	(17,459)	(17,459)
Stock-based compensation expense	—	—	6,083	—	—	6,083
Settlement of liability classified RSUs	—	—	1,589	—	—	1,589
Issuance of common stock under stock-based compensation plans	859	1	24	—	—	25
Issuance of common stock under Employee Stock Purchase Plan	378	—	1,171	—	—	1,171
Restricted stock unit withholdings	(299)	—	(1,483)	—	—	(1,483)
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	(14)	—	(14)
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	(9)	—	(9)
Balance as of September 27, 2020	<u>79,027</u>	<u>\$ 79</u>	<u>\$ 359,297</u>	<u>\$ (9)</u>	<u>\$ (217,560)</u>	<u>\$ 141,807</u>

Common Stock						
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
(In thousands)						
Balance as of June 30, 2019	74,869	\$ 75	\$ 323,648	\$ 51	\$ (120,544)	\$ 203,230
Net loss	—	—	—	—	(30,590)	(30,590)
Stock-based compensation expense	—	—	5,219	—	—	5,219
Issuance of common stock under stock-based compensation plans	88	—	—	—	—	—
Issuance of common stock under Employee Stock Purchase Plan	767	1	1,824	—	—	1,825
Restricted stock unit withholdings	(18)	—	(73)	—	—	(73)
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	(27)	—	(27)
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	22	—	22
Balance as of September 29, 2019	<u>75,706</u>	<u>\$ 76</u>	<u>\$ 330,618</u>	<u>\$ 46</u>	<u>\$ (151,134)</u>	<u>\$ 179,606</u>

	Common Stock			Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	Shares	Amount	Additional Paid-In Capital			
	(In thousands)					
Balance as of December 31, 2019	75,786	\$ 76	\$ 334,821	\$ (2)	\$ (131,519)	\$ 203,376
Net loss	—	—	—	—	(86,041)	(86,041)
Stock-based compensation expense	—	—	21,840	—	—	21,840
Settlement of liability classified RSUs	—	—	4,219	—	—	4,219
Issuance of common stock under stock-based compensation plans	3,384	3	24	—	—	27
Issuance of common stock under Employee Stock Purchase Plan	1,110	1	3,024	—	—	3,025
Restricted stock unit withholdings	(1,253)	(1)	(4,631)	—	—	(4,632)
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	(23)	—	(23)
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	16	—	16
Balance as of September 27, 2020	79,027	\$ 79	\$ 359,297	\$ (9)	\$ (217,560)	\$ 141,807

	Common Stock			Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	Shares	Amount	Additional Paid-In Capital			
	(In thousands)					
Balance as of December 31, 2018	74,247	\$ 74	\$ 315,277	\$ —	\$ (45,849)	\$ 269,502
Cumulative-effect adjustment from adoption of ASC 842, net of tax	—	—	—	—	281	281
Net loss	—	—	—	—	(105,566)	(105,566)
Stock-based compensation expense	—	—	15,261	—	—	15,261
Issuance of common stock under stock-based compensation plans	1,041	1	11	—	—	12
Issuance of common stock under Employee Stock Purchase Plan	767	1	1,824	—	—	1,825
Restricted stock unit withholdings	(349)	—	(1,755)	—	—	(1,755)
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	46	—	46
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	—	—	—
Balance as of September 29, 2019	75,706	\$ 76	\$ 330,618	\$ 46	\$ (151,134)	\$ 179,606

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

ARLO TECHNOLOGIES, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	September 27, 2020	September 29, 2019
	(In thousands)	
Cash flows from operating activities:		
Net loss	\$ (86,041)	\$ (105,566)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	8,024	7,757
Loss on disposal of fixed assets	19	—
Premium amortization (discount accretion) on investments, net	60	(391)
Stock-based compensation expense	26,338	15,261
Allowance for (release of) credit losses and inventory reserves	1,322	(3,232)
Gain on sale of business	(292)	—
Deferred income taxes	63	(109)
Changes in assets and liabilities:		
Accounts receivable, net	70,985	65,920
Inventories	(1,838)	54,335
Prepaid expenses and other assets	8,369	(1,729)
Accounts payable	(37,554)	(24,381)
Deferred revenue	(27,569)	(1,996)
Accrued and other liabilities	(21,203)	(48,584)
Net cash used in operating activities	(59,317)	(42,715)
Cash flows from investing activities:		
Purchases of property and equipment	(2,070)	(5,023)
Purchases of short-term investments	(45,085)	(29,768)
Proceeds from maturities of short-term investments	45,000	40,000
Net cash provided by (used in) investing activities	(2,155)	5,209
Cash flows from financing activities:		
Proceeds related to employee benefit plans	3,051	1,837
Restricted stock unit withholdings	(4,632)	(1,755)
Net cash provided by (used in) financing activities	(1,581)	82
Net decrease in cash and cash equivalents and restricted cash	(63,053)	(37,424)
Cash and cash equivalents and restricted cash, at beginning of period	240,819	155,424
Cash and cash equivalents and restricted cash, at end of period	\$ 177,766	\$ 118,000
Non-cash investing and financing activities:		
Purchases of property and equipment included in accounts payable and accrued liabilities	\$ 1,470	\$ 1,578
De-recognition of build-to-suit assets and liabilities	\$ —	\$ (21,610)

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

ARLO TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Basis of Presentation

The Company

Arlo Technologies, Inc ("the Company") combines an intelligent cloud infrastructure and mobile app with a variety of smart connected devices that transform the way people experience the connected lifestyle. The Company's cloud-based platform provides users with visibility, insight and a powerful means to help protect and connect in real-time with the people and things that matter most, from any location with a Wi-Fi or a cellular connection. The Company conducts business across three geographic regions - Americas; Europe, Middle-East and Africa ("EMEA"); and Asia Pacific ("APAC") and primarily generates revenue by selling devices through retail channels, wholesale distribution, wireless carrier channels, security channels, Arlo online store and paid subscription services.

The Company has dual corporate headquarters located in San Jose, California and Carlsbad, California and also maintains offices to provide sales and customer support at various global locations.

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All periods presented have been accounted for in conformity with U.S. Generally Accepted Accounting Principles ("U.S. GAAP") and pursuant to the regulations of the U.S. Securities and Exchange Commission ("SEC").

These unaudited condensed consolidated financial statements should be read in conjunction with the notes to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for fair statement of the unaudited condensed consolidated financial statements for interim periods.

Reclassification

Certain reclassifications have been made to the prior year's condensed consolidated statements of cash flows to conform to the current year's presentation. The reclassifications had no effect on the net cash used (provided by) in operating activities, investing activities or financing activities on the prior year's statement of cash flows.

Fiscal periods

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

Use of estimates

The preparation of these unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Management bases its estimates on various assumptions believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ materially from those estimates and operating results for the nine months ended September 27,

ARLO TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2020 are not necessarily indicative of the results that may be expected for the year ending December 31, 2020 or any future period.

Note 2. Significant Accounting Policies and Recent Accounting Pronouncements

The Company's significant accounting policies are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2019. There have been no significant changes during the nine months ended September 27, 2020, other than the accounting policies discussed below and the recent accounting pronouncements adopted and discussed below under Accounting Pronouncements Recently Adopted.

Trade accounts receivable

The Company is exposed to credit losses primarily through sales of products and services. The Company's allowance for current estimated credit losses for trade accounts receivable is developed using historical collection experience, current and future economic and market conditions and a review of the current status of customers' trade accounts receivables. Due to the short-term nature of such receivables, the estimated amount of accounts receivable that may not be collected is based on aging of the accounts receivable balances and the financial condition of customers. Additionally, specific allowance amounts are established to record the appropriate provision for customers that have a higher probability of default.

The Company's monitoring activities include timely and regular account reconciliations, dispute resolution, payment confirmation, review of customers' financial condition and macroeconomic conditions. Balances are written off when determined to be uncollectible. The Company considered the current and expected future economic and market conditions surrounding the novel coronavirus ("COVID-19") pandemic and determined that the estimate of credit losses was not significantly impacted. Although the Company has historically not experienced significant credit losses, it is possible that there could be a material adverse impact from potential adjustments of the carrying amount of trade receivables.

Recent accounting pronouncements

Emerging Growth Company Status

As an emerging growth company ("EGC"), the Jumpstart Our Business Startups Act of 2012 ("JOBS Act") allows the Company to delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies, unless the Company otherwise irrevocably elects not to avail itself of this exemption. The Company did not make such an irrevocable election and has not delayed the adoption of any applicable accounting standards.

Accounting Pronouncements Recently Adopted

ASU 2016-13 - Measurement of Credit Losses on Financial Instruments

In June 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments" (Topic 326), which replaces the incurred-loss impairment methodology and requires immediate recognition of estimated credit losses expected to occur for most financial assets, including trade receivables. Credit losses on available-for-sale debt securities with unrealized losses will be recognized as allowances for credit losses, limited to the amount by which fair value is below amortized cost. The Company adopted Topic 326 on January 1, 2020, using a modified retrospective transition method, which requires a cumulative-effect adjustment, if any, to the opening balance of retained earnings to be recognized on the date of adoption with prior periods not restated. The cumulative-effect adjustment recorded on January 1, 2020 is immaterial.

ARLO TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ASU 2019-12 - Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes

In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes" ("ASU 2019-12"), which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. ASU 2019-12 is effective for the Company beginning January 1, 2022 (or January 1, 2021 should the Company cease to be classified as an EGC), with early adoption permitted. The Company early adopted ASU 2019-12 in the first quarter of 2020. The impact of the adoption of ASU 2019-12 on the Company's financial statements is immaterial.

Accounting Pronouncements Not Yet Effective

In March 2020, the FASB issued ASU 2020-04, "Facilitation of the Effects of Reference Rate Reform on Financial Reporting". The accounting standards update is intended to provide temporary optional expedients and exceptions to the U.S. GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens related to the expected market transition from the London Interbank Offered Rate ("LIBOR") and other interbank offered rates to alternative reference rates. This guidance may be applied prospectively through December 31, 2022. The Company is currently evaluating the impact this guidance may have on its financial statements and related disclosures.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to the Company's financial position, results of operations, or cash flows.

Note 3. Deferred Revenue

Deferred Revenue

Deferred revenue consists of advance payments and deferred revenue, where the Company has unsatisfied performance obligations. Deferred revenue consists of prepaid services and customer billings in advance of revenues being recognized from the Company's subscription contracts. Advance payments include prepayments for products and Non-Recurring Engineering ("NRE") services under the Supply Agreement with Verisure S.à.r.l. ("Verisure"). Refer to Note 4, *Disposal of Business*, for a complete discussion of Verisure transaction.

Transaction Price Allocated to the Remaining Performance Obligations

Remaining performance obligations represent the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied as of the end of the reporting period. Unsatisfied and partially unsatisfied performance obligations consist of contract liabilities, in-transit orders with destination terms, and non-cancellable backlog. Non-cancellable backlog includes goods and services for which customer purchase orders have been accepted and that are scheduled or in the process of being scheduled for shipment.

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) as of September 27, 2020:

	1 year	2 years	Greater than 2 years	Total
	(In thousands)			
Performance obligations	\$ 50,987	\$ 6,766	\$ 1,517	\$ 59,270

The performance obligation classified as greater than one year pertains to revenue deferral from prepaid services.

ARLO TECHNOLOGIES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 27, 2020 and September 29, 2019, \$33.5 million and \$32.6 million of revenue was deferred due to unsatisfied performance obligations, primarily relating to over time service revenue, and \$46.9 million and \$34.6 million of revenue was recognized for the satisfaction of performance obligations over time, respectively. \$21.2 million and \$22.1 million of this recognized revenue was included in the contract liability balance at the beginning of the periods. There were no significant changes in estimates during the period that would affect the contract balances.

Disaggregation of Revenue

The Company conducts business across three geographic regions: Americas, EMEA, and APAC. Sales and usage-based taxes are excluded from revenue. Refer to Note 14, *Segment and Geographic Information*, for revenue by geography.

Note 4. Disposal of Business

On November 4, 2019, the Company and Verisure concurrently entered into an Asset Purchase Agreement (the "Purchase Agreement") and Supply Agreement (the "Supply Agreement" and together with the Purchase Agreement, the "Verisure Agreements"). The Verisure Agreements created a strategic partnership that leverages both the Company and Verisure's capabilities to create incremental scale to address the ever-growing demand for residential and commercial security. The strategic partnership combines the Company's innovative connected cameras and cloud services platform with Verisure's professionally monitored security solutions to provide a new level of smart security for European customers. The Purchase Agreement provided that, upon the terms and subject to the conditions set forth in the Purchase Agreement, the Company transferred, sold and assigned to Verisure certain assets (the "Assets") related to the Company's commercial operations in Europe (the "Business") to Verisure for \$50.0 million in cash plus additional cash for certain inventory. The Purchase Agreement contained customary representations and warranties regarding Verisure, the Business and the Assets, indemnification provisions, termination rights and other customary provisions. Further, the Company has agreed not to engage in any business that competes with the Business for a period of three years.

The transaction closed on December 30, 2019 pursuant to which the Company received \$52.7 million including working capital adjustments, which resulted in a pretax gain of \$54.9 million in the fourth fiscal quarter of 2019. In the first fiscal quarter of 2020, the Company recorded an additional gain of \$292 thousand that was recorded in Gain on sale of business in the Company's unaudited condensed consolidated statements of operations as a result of the final working capital adjustment.

The assets and liabilities sold and assigned to Verisure were determined to have met the criteria to be classified as held for sale as of November 4, 2019, the execution date of the Purchase Agreement. The transaction contemplated by the Purchase Agreement did not meet the criteria for discontinued operations as the Company is expected to have continued involvement in Europe through manufacturing and shipping of products to the region through sales to Verisure as part of the Supply Agreement and therefore no significant change in revenue from the region is expected; it was determined the transaction did not represent a strategic shift. The Company also assessed whether a loss needed to be recorded upon initial classification of the assets and liabilities as held for sale to adjust its carrying amount to the fair value less cost to sell. As the carrying amount of the assets and liabilities was lower than fair value less cost to sell, no adjustment was necessary. As of the closing date of December 30, 2019, the Company concluded that no impairment existed for the assets and no adjustment was necessary for the liabilities. Further, the Company reassessed the fair value and cost to sell, and noted that they had not changed since the initial classification of the assets and liabilities as held for sale. Given such, no loss adjustment was necessary.

The Supply Agreement provides that Verisure is the exclusive distributor of the Company's products in Europe for all channels, and will non-exclusively distribute the Company's products through its direct channels globally for an initial term of five years. During the five-year period commencing January 1, 2020, Verisure has an aggregate minimum

ARLO TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

purchase commitment of \$500.0 million, which includes annual minimum commitments. On December 30, 2019, Verisure prepaid the Company \$20.0 million for product purchases in fiscal 2020 and will prepay \$40.0 million on the first anniversary of the closing of the Purchase Agreement for product purchases in fiscal 2021.

The Supply Agreement also includes certain NRE services to be delivered to Verisure, including developing certain custom products specified by Verisure in exchange for an aggregate of \$10.0 million, payable in installments upon meeting certain development milestones. In the second fiscal quarter of 2020, an additional \$3.5 million was added to the contract price as a result of a modification to Verisure's specification for the Outdoor Custom Camera. As of September 27, 2020, Verisure has paid \$5.0 million for this NRE service. For the three and nine months ended September 27, 2020, the Company recognized service revenue of \$2.3 million and \$5.5 million, respectively, for this NRE service.

As part of the Purchase Agreement, the Company also entered into a Transition Services Agreement with Verisure ("Verisure TSA") to assist Verisure with the transition of the Company's European commercial operations. These transition services primarily include IT support for 12 months, and other services for three to six months, including sales and marketing, operations and supply chain, finance, legal, and human resources which may be extended as mutually agreed upon by the parties. As compensation for these transition services, the Company will be reimbursed by Verisure based on actual direct costs plus allocation of overhead. For the three and nine months ended September 27, 2020, the Company charged Verisure \$0.9 million and \$3.0 million, respectively, for Verisure TSA services which were recorded as Other income, given such services are not related to the primary business in which the Company operates. The related Verisure TSA expenses in the same amount were recognized as incurred and reported under their natural expense classification.

Note 5. Balance Sheet Components
Cash and Cash Equivalents and Restricted cash

The Company maintains certain cash balances restricted as to withdrawal or use. The restricted cash is comprised primarily of cash used as a collateral for a letter of credit associated with the Company's lease agreement for its headquarters in San Jose, California. The Company deposits restricted cash with high credit quality financial institutions. The following table provides a reconciliation of cash and cash equivalents and restricted cash reported within the balance sheets that sum to the total of the same amounts shown on the statements of cash flows:

	As of	
	September 27, 2020	December 31, 2019
	(In thousands)	
Cash and cash equivalents	\$ 173,619	\$ 236,680
Restricted cash	4,147	4,139
Total as presented on the unaudited condensed consolidated statements of cash flows	\$ 177,766	\$ 240,819

	As of	
	September 29, 2019	December 31, 2018
	(In thousands)	
Cash and cash equivalents	\$ 113,870	\$ 151,290
Restricted cash	4,130	4,134
Total as presented on the unaudited condensed consolidated statements of cash flows	\$ 118,000	\$ 155,424

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Available-for-sale short-term investments

	As of September 27, 2020				As of December 31, 2019			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(In thousands)							
U.S. treasuries	\$ 19,992	\$ —	\$ —	\$ 19,992	\$ 19,967	\$ 23	\$ —	\$ 19,990

The Company's short-term investments are classified as available-for-sale and consist of government securities with an original maturity or remaining maturity at the time of purchase of greater than three months and no more than 12 months. Accordingly, none of the available-for-sale securities have unrealized losses greater than 12 months. The Company did not recognize any allowance for credit losses related to available for sale short-term investment for the three and nine months ended September 27, 2020.

Accounts receivable, net

	As of	
	September 27, 2020	December 31, 2019
	(In thousands)	
Gross accounts receivable	\$ 56,940	\$ 127,926
Allowance for credit losses	(509)	(609)
Total accounts receivable, net	<u>\$ 56,431</u>	<u>\$ 127,317</u>

The following table provides a roll-forward of the allowance for credit losses that is deducted from the amortized cost basis of accounts receivable to present the net amount expected to be collected.

	Three Months Ended September 27, 2020	Nine Months Ended September 27, 2020
	(In thousands)	
Balance at the beginning of the period	\$ 810	\$ 609
Provision for (recovery of) expected credit losses	(301)	(100)
Amounts written off charged against the allowance	—	—
Balance at the end of the period	<u>\$ 509</u>	<u>\$ 509</u>

Inventories

Inventories consist of finished goods which are valued at the lower of cost or net realizable value, with cost being determined using the first-in, first-out method as of September 27, 2020.

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Property and equipment, net

The components of property and equipment are as follows:

	As of	
	September 27, 2020	December 31, 2019
	(In thousands)	
Machinery and equipment	\$ 14,699	\$ 13,402
Software	12,657	11,945
Computer equipment	4,094	4,047
Furniture and fixtures	4,045	4,075
Leasehold improvements	8,023	8,087
Total property and equipment, gross	43,518	41,556
Accumulated depreciation and amortization	(26,686)	(20,204)
Total property and equipment, net	\$ 16,832	\$ 21,352

Depreciation and amortization expense pertaining to property and equipment was \$2.2 million and \$7.0 million for the three and nine months ended September 27, 2020, respectively, and \$2.4 million and \$6.6 million for the three and nine months ended September 29, 2019, respectively.

Intangibles, net

	As of September 27, 2020			As of December 31, 2019		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(In thousands)					
Technology	\$ 9,800	\$ (9,571)	\$ 229	\$ 9,800	\$ (8,540)	\$ 1,260
Other	500	(491)	9	500	(454)	46
Total intangibles, net	\$ 10,300	\$ (10,062)	\$ 238	\$ 10,300	\$ (8,994)	\$ 1,306

As of September 27, 2020, the remaining weighted-average estimated useful life of intangibles was 0.2 years. Amortization of intangibles was \$0.4 million and \$1.1 million for the three and nine months ended September 27, 2020, respectively, and \$0.4 million and \$1.2 million for the three and nine months ended September 29, 2019, respectively. There was no impairment recorded for the three and nine months ended September 27, 2020 and September 29, 2019.

As of September 27, 2020, estimated amortization expense related to finite-lived intangibles for the remaining year was \$0.2 million.

Goodwill

There was no change in the carrying amount of goodwill during the nine months ended September 27, 2020 and the goodwill as of December 31, 2019 and September 27, 2020 was \$11.0 million.

Goodwill Impairment

The Company performs an annual assessment of goodwill at the reporting unit level on the first day of the fourth fiscal quarter and during interim periods if there are triggering events to reassess goodwill. The Company operates as one operating and reportable segment.

In the first fiscal quarter 2020, the uncertainty brought about by the COVID-19 pandemic adversely impacted the Company's stock price. The resulting impact to the Company's market capitalization is a qualitative factor to consider when evaluating whether events or changes in circumstances indicate that it is more likely than not that a

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potential goodwill impairment exists. The Company concluded that the decline in the price of its common stock as a result of the COVID-19 impact was an indicator that the Company's goodwill might be impaired. As a result, in the first fiscal quarter of 2020, the Company performed a quantitative assessment using the discounted cash flow model ("DCF model") as of March 29, 2020. The Company estimated the fair value of the business using the DCF model, as management believes forecasted operating cash flows are the best indicator of current fair value. The assumptions used in the DCF model include weighted-average cost of capital, projected revenue based on projected revenue growth rate, projected operating expenses, income taxes as well as capital expenditures and change in working capital. Estimating the fair value of the business was a subjective process involving the use of estimates and judgments, particularly related to future cash flows, which are inherently uncertain. Based on the results of the quantitative assessment using the DCF model, as of March 29, 2020, the respective fair value was substantially in excess of the carrying amount by \$94.1 million, or 53%.

The Company determined that no events occurred or circumstances changed during the three months ended September 27, 2020 that would more likely than not reduce the fair value of the Company below its carrying amount. If there is a further decline in the Company's stock price based on market conditions and deterioration of the Company's business, the Company may have to record a charge to its earnings for the associated goodwill impairment of up to \$11.0 million.

Other non-current assets

	As of	
	September 27, 2020	December 31, 2019
	(In thousands)	
Non-current deferred income taxes	\$ 1,255	\$ 1,318
Deposits	122	764
Other	839	1,926
Total other non-current assets	<u>\$ 2,216</u>	<u>\$ 4,008</u>

Accrued liabilities

	As of	
	September 27, 2020	December 31, 2019
	(In thousands)	
Sales and marketing	\$ 37,767	\$ 53,974
Sales returns	25,193	28,817
Accrued employee compensation	9,751	11,795
Current operating lease liabilities	4,376	3,912
Warranty obligation	2,568	3,169
Freight	2,675	2,690
Other	23,697	23,043
Total accrued liabilities	<u>\$ 106,027</u>	<u>\$ 127,400</u>

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Note 6. Fair Value Measurements

The following table summarizes assets and liabilities measured at fair value on a recurring basis as of September 27, 2020 and December 31, 2019:

	As of September 27, 2020			As of December 31, 2019		
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)
(In thousands)						
Assets:						
Cash equivalents: money-market funds (<90 days)	\$ 1,933	\$ 1,933	\$ —	\$ 31,472	\$ 31,472	\$ —
Available-for-sale securities: U.S. treasuries ⁽¹⁾	19,992	19,992	—	19,990	19,990	—
Foreign currency forward contracts ⁽²⁾	110	—	110	27	—	27
Total assets measured at fair value	\$ 22,035	\$ 21,925	\$ 110	\$ 51,489	\$ 51,462	\$ 27
Liabilities:						
Foreign currency forward contracts ⁽³⁾	\$ 5	\$ —	\$ 5	\$ 375	\$ —	\$ 375
Total liabilities measured at fair value	\$ 5	\$ —	\$ 5	\$ 375	\$ —	\$ 375

⁽¹⁾ Included in Short-term investments on the Company's unaudited condensed consolidated balance sheets.

⁽²⁾ Included in Prepaid expenses and other current assets on the Company's unaudited condensed consolidated balance sheets.

⁽³⁾ Included in Accrued liabilities on the Company's unaudited condensed consolidated balance sheets.

The Company's investments in cash equivalents and available-for-sale securities are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company enters into foreign currency forward contracts with only those counterparties that have long-term credit ratings of A-/A3 or higher. The Company's foreign currency forward contracts are classified within Level 2 of the fair value hierarchy as they are valued using pricing models that take into account the contract terms as well as currency rates and counterparty credit rates. The Company verifies the reasonableness of these pricing models using observable market data for related inputs into such models. Additionally, the Company includes an adjustment for non-performance risk in the recognized measure of fair value of derivative instruments. As of September 27, 2020 and December 31, 2019, the adjustment for non-performance risk did not have a material impact on the fair value of the Company's foreign currency forward contracts. The carrying value of non-financial assets and liabilities measured at fair value in the financial statements on a recurring basis, including accounts receivable and accounts payable, approximate fair value due to their short maturities. As of September 27, 2020 and December 31, 2019, the Company has no Level 3 fair value assets or liabilities.

Note 7. Derivative Financial Instruments

The Company's subsidiaries have had, and will continue to have material future cash flows, including revenue and expenses, which are denominated in currencies other than the Company's functional currency. The Company and all its subsidiaries designate the U.S. dollar as the functional currency. Changes in exchange rates between the Company's functional currency and other currencies in which the Company transacts business will cause fluctuations in cash flow expectations and cash flow realized or settled. Accordingly, the Company uses derivatives to mitigate its business exposure to foreign exchange risk. The Company enters into foreign currency forward contracts in Australian dollars, euros, and Canadian dollars to manage its exposure to foreign exchange risk related to expected future cash flows on certain forecasted revenue, costs of revenue, operating expenses and existing assets and liabilities.

The Company's foreign currency forward contracts do not contain any credit risk-related contingent features. The Company is exposed to credit losses in the event of nonperformance by the counter-parties of its forward contracts.

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The Company enters into derivative contracts with high-quality financial institutions and limits the amount of credit exposure to any one counter-party. In addition, the derivative contracts typically mature in less than six months and the Company continuously evaluates the credit standing of its counter-party financial institutions. The counter-parties to these arrangements are large, highly rated financial institutions and the Company does not consider non-performance a material risk.

The Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including, but not limited to, materiality, accounting considerations or the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign exchange rates. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with the authoritative guidance for derivatives and hedging. The Company records all derivatives on the balance sheets at fair value. Cash flow hedge gains and losses are recorded in other comprehensive income ("OCI") until the hedged item is recognized in earnings. Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings in Other income (expense), net in the unaudited condensed consolidated statements of operations.

Fair value of derivative instruments

The fair values of the Company's derivative instruments and the line items on the unaudited condensed consolidated balance sheets to which they were recorded as of September 27, 2020 and December 31, 2019 are summarized as follows:

Derivative Assets	Balance Sheet Location	September 27, 2020	December 31, 2019	Balance Sheet Location	September 27, 2020	December 31, 2019
		(In thousands)			(In thousands)	
Derivative assets not designated as hedging instruments	Prepaid expenses and other current assets	\$ 108	\$ 27	Accrued liabilities	\$ 5	\$ 347
Derivative assets designated as hedging instruments	Prepaid expenses and other current assets	2	—	Accrued liabilities	—	28
Total		<u>\$ 110</u>	<u>\$ 27</u>		<u>\$ 5</u>	<u>\$ 375</u>

Refer to Note 6, *Fair Value Measurements*, for detailed disclosures regarding fair value measurements in accordance with the authoritative guidance for fair value measurements and disclosures.

Gross amounts offsetting of derivative instruments

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

The following tables set forth the offsetting of derivative assets as of September 27, 2020 and December 31, 2019:

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As of September 27, 2020	Gross Amounts Not Offset in the Unaudited Condensed Consolidated Balance Sheets					
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Unaudited Condensed Consolidated Balance Sheets	Net Amounts Of Assets Presented in the Unaudited Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
HSBC	\$ 29	\$ —	\$ 29	\$ (5)	\$ —	\$ 24
Wells Fargo Bank	81	—	81	—	—	81
Total	<u>\$ 110</u>	<u>\$ —</u>	<u>\$ 110</u>	<u>\$ (5)</u>	<u>\$ —</u>	<u>\$ 105</u>

As of December 31, 2019	Gross Amounts Not Offset in the Unaudited Condensed Consolidated Balance Sheets					
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Unaudited Condensed Consolidated Balance Sheets	Net Amounts Of Assets Presented in the Unaudited Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
HSBC	\$ 6	\$ —	\$ 6	\$ (6)	\$ —	\$ —
Wells Fargo Bank	21	—	21	(21)	—	—
Total	<u>\$ 27</u>	<u>\$ —</u>	<u>\$ 27</u>	<u>\$ (27)</u>	<u>\$ —</u>	<u>\$ —</u>

The following tables set forth the offsetting of derivative liabilities as of September 27, 2020 and December 31, 2019:

As of September 27, 2020	Gross Amounts Not Offset in the Unaudited Condensed Consolidated Balance Sheets					
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Unaudited Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Unaudited Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
HSBC	\$ 5	\$ —	\$ 5	\$ (5)	\$ —	\$ —
Wells Fargo Bank	—	—	—	—	—	—
Total	<u>\$ 5</u>	<u>\$ —</u>	<u>\$ 5</u>	<u>\$ (5)</u>	<u>\$ —</u>	<u>\$ —</u>

As of December 31, 2019	Gross Amounts Not Offset in the Unaudited Condensed Consolidated Balance Sheets					
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Unaudited Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Unaudited Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral Pledged	Net Amount
	(In thousands)					
HSBC	\$ 83	\$ —	\$ 83	\$ (6)	\$ —	\$ 77
Wells Fargo Bank	292	—	292	(21)	—	271
Total	<u>\$ 375</u>	<u>\$ —</u>	<u>\$ 375</u>	<u>\$ (27)</u>	<u>\$ —</u>	<u>\$ 348</u>

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Cash flow hedges

The Company typically hedges portions of its anticipated foreign currency exposure which generally are less than six months. The Company entered into four forward contracts related to its cash flow hedging program for the three months ended September 27, 2020. The effects of the Company's cash flow hedges from the contracts placed in the third quarter of 2020 on the unaudited condensed consolidated statements of operations for the three and nine months ended September 27, 2020 are summarized as follows:

Three Months Ended September 27, 2020					
Location and Amount of Gains (Losses) Recognized in Income on Cash Flow Hedges					
Revenue	Cost of revenue	Research and development	Sales and marketing	General and administrative	
(In thousands)					
Statements of operations	\$ 110,236	\$ 88,827	\$ 15,436	\$ 12,720	\$ 11,137
Gains (losses) on cash flow hedge	\$ (37)	\$ —	\$ 5	\$ 2	\$ —

Nine Months Ended September 27, 2020					
Location and Amount of Gains (Losses) Recognized in Income on Cash Flow Hedges					
Revenue	Cost of revenue	Research and development	Sales and marketing	General and administrative	
(In thousands)					
Statements of operations	\$ 242,318	\$ 211,467	\$ 44,871	\$ 35,471	\$ 39,758
Gains (losses) on cash flow hedge	\$ (14)	\$ —	\$ 5	\$ 3	\$ —

The effects of the Company's cash flow hedges on the unaudited condensed consolidated statements of operations for the three and nine months ended September 29, 2019 are summarized as follows:

Three Months Ended September 29, 2019					
Location and Amount of Gains (Losses) Recognized in Income on Cash Flow Hedges					
Revenue	Cost of revenue	Research and development	Sales and marketing	General and administrative	
(In thousands)					
Statements of operations	\$ 106,116	\$ 95,613	\$ 16,701	\$ 13,657	\$ 11,062
Gains (losses) on cash flow hedge	\$ 86	\$ —	\$ (3)	\$ (3)	\$ (2)

Nine Months Ended September 29, 2019					
Location and Amount of Gains (Losses) Recognized in Income on Cash Flow Hedges					
Revenue	Cost of revenue	Research and development	Sales and marketing	General and administrative	
(In thousands)					
Statements of operations	\$ 247,594	\$ 225,496	\$ 52,456	\$ 42,389	\$ 32,512
Gains (losses) on cash flow hedge	\$ 333	\$ (2)	\$ (24)	\$ (38)	\$ (11)

The Company expects to reclassify to earnings all of the amounts recorded in AOCI (as defined below) associated with its cash flow hedges over the next 12 months. For information on the unrealized gains or losses on derivatives reclassified out of AOCI into the unaudited condensed consolidated statements of operations, refer to Note 8, *Accumulated Other Comprehensive Income (Loss)*.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur within the designated hedge period or if not recognized within 60 days following the end of the hedge period. The Company did not recognize any material net gains or losses related to the loss of hedge designation as there were no discontinued cash flow hedges during the nine months ended September 27, 2020 and September 29, 2019.

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Non-designated hedges

The Company adjusts its non-designated hedges monthly and enters into about nine non-designated derivatives per quarter with an average size of \$2.1 million. The hedges range typically from one to three months in duration. The effects of the Company's non-designated hedge included in Other income (expense), net on the unaudited condensed consolidated statements of operations for the three and nine months ended September 27, 2020 and September 29, 2019 were as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gains (Losses) Recognized in Income on Derivative	Three Months Ended		Nine Months Ended	
		September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
		(In thousands)			
Foreign currency forward contracts	Other income (expense), net	\$ (108)	\$ 665	\$ 553	\$ 521

Note 8. Accumulated Other Comprehensive Income (Loss)

The following table sets forth the changes in accumulated other comprehensive income (loss) ("AOCI") by component for the three and nine months ended September 27, 2020 and September 29, 2019:

	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
(In thousands)				
Balance as of June 28, 2020	\$ 14	\$ —	\$ —	\$ 14
Other comprehensive income (loss) before reclassifications	(14)	(39)	—	(53)
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	(30)	—	(30)
Net current period other comprehensive income (loss)	(14)	(9)	—	(23)
Balance as of September 27, 2020	\$ —	\$ (9)	\$ —	\$ (9)

	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
(In thousands)				
Balance as of December 31, 2019	\$ 23	\$ (25)	\$ —	\$ (2)
Other comprehensive income (loss) before reclassifications	(23)	10	—	(13)
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	(6)	—	(6)
Net current period other comprehensive income (loss)	(23)	16	—	(7)
Balance as of September 27, 2020	\$ —	\$ (9)	\$ —	\$ (9)

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	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
(In thousands)				
Balance as of June 30, 2019	\$ 72	\$ (22)	\$ 1	\$ 51
Other comprehensive income (loss) before reclassifications	(27)	100	—	73
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	78	—	78
Net current period other comprehensive income (loss)	(27)	22	—	(5)
Balance as of September 29, 2019	<u>\$ 45</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ 46</u>

	Unrealized gains (losses) on available-for-sale securities	Unrealized gains (losses) on derivatives	Estimated tax benefit (provision)	Total
(In thousands)				
Balance as of December 31, 2018	\$ (2)	\$ 2	\$ —	\$ —
Other comprehensive income (loss) before reclassifications	47	256	1	304
Less: Amount reclassified from accumulated other comprehensive income (loss)	—	258	—	258
Net current period other comprehensive income (loss)	47	(2)	1	46
Balance as of September 29, 2019	<u>\$ 45</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ 46</u>

The following tables provide details about significant amounts reclassified out of each component of AOCI for the three and nine months ended September 27, 2020 and September 29, 2019:

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Three Months Ended								
September 27, 2020			September 29, 2019					
Gains (Losses) Recognized in OCI - Effective Portion	Gains (Losses) Reclassified from OCI to Income - Effective Portion		Gains (Losses) Recognized in OCI - Effective Portion	Gains (Losses) Reclassified from OCI to Income - Effective Portion	Affected Line Item in the Statements of Operations			
(In thousands)								
\$	(39)	\$	(37)	\$	100	\$	86	Revenue
	—		—		—		—	Cost of revenue
	—		5		—		(3)	Research and development
	—		2		—		(3)	Sales and marketing
	—		—		—		(2)	General and administrative
<u>\$</u>	<u>(39)</u>	<u>\$</u>	<u>(30)</u>	<u>\$</u>	<u>100</u>	<u>\$</u>	<u>78</u>	Total *
Nine Months Ended								
September 27, 2020			September 29, 2019					
Gains (Losses) Recognized in OCI - Effective Portion	Gains (Losses) Reclassified from OCI to Income - Effective Portion		Gains (Losses) Recognized in OCI - Effective Portion	Gains (Losses) Reclassified from OCI to Income - Effective Portion		Affected Line Item in the Statements of Operations		
(In thousands)								
\$	10	\$	(14)	\$	257	\$	333	Revenue
	—		—		—		(2)	Cost of revenue
	—		5		—		(24)	Research and development
	—		3		—		(38)	Sales and marketing
	—		—		—		(11)	General and administrative
<u>\$</u>	<u>10</u>	<u>\$</u>	<u>(6)</u>	<u>\$</u>	<u>257</u>	<u>\$</u>	<u>258</u>	Total *

* Tax impact to hedging gains and losses from derivative contracts was immaterial.

Note 9. Debt

Revolving Credit Facility

On November 5, 2019, the Company entered into a Business Financing Agreement (the “Credit Agreement”) with Western Alliance Bank, an Arizona corporation, as lender (the “Lender”).

The Credit Agreement provides for a two-year revolving credit facility (the “Credit Facility”) that matures on November 5, 2021 and that may, by its terms, be extended by mutual written agreement between the Company and the Lender. Borrowings under the Credit Facility are limited to the lesser of (x) \$40.0 million, and (y) an amount equal to the borrowing base. The borrowing base will be 60% of the Company’s eligible receivables and eligible accounts receivable, less such reserves as the Lender may deem proper and necessary from time to time. The Lender is not required to make any advance under the Credit Facility during the period beginning on January 1st and continuing through June 30th, except for advances made against eligible receivables first invoiced between July 1 and December 31, 2019. The Credit Agreement also includes sublimits for the issuance by the Lender of letters of credit, credit card indebtedness and foreign exchange forward contract. Repayment of the borrowings under the Credit Facility are due upon collection of the eligible receivables. The proceeds of the borrowings under the Credit Facility may be used for working capital and general corporate purposes.

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The obligations of the Company under the Credit Agreement are secured by substantially all of the Company's domestic personal property, excluding intellectual property assets and more than 65% of the shares of voting capital stock of any of the Company's foreign subsidiaries.

Borrowings under the Credit Agreement generally bear interest at floating rates based upon the prime rate subject to a floor rate of five percent (5%) plus two and one-quarter percentage points (2.25%), plus an additional five percentage points (5%) during any period that an event of default has occurred and is continuing. Among other fees, the Company is required to pay an annual facility fee equal to 0.25% of the limit under the Credit Facility due upon entry into the Credit Agreement and on each anniversary thereof. The annual facility fee is capitalized and being amortized as interest expense over a 12-month period. The Company incurred debt issuance costs for the Credit Agreement, which are recorded in prepaid expenses and other current assets in the Company's unaudited condensed consolidated balance sheets and are being amortized as interest expense over the contractual term of the Credit Agreement.

The Credit Agreement contains customary events of default and other restrictions, including a financial covenant that requires the Company to maintain certain amount of domestic cash and certain restrictions on the Company's ability to incur additional indebtedness, consolidate or merge, enter into acquisitions, pay any dividend or distribution on the Company's capital stock, redeem, retire or purchase shares of the Company's capital stock, make investments or pledge or transfer assets, in each case subject to limited exceptions. If an event of default under the Credit Agreement occurs, then the Lender may cease making advances under the Credit Agreement and declare any outstanding obligations under the Credit Agreement to be immediately due and payable. In addition, if the Company files a bankruptcy petition, a bankruptcy petition is filed against the Company and is not dismissed or stayed within forty-five days, or the Company makes a general assignment for the benefit of creditors, then any outstanding obligations under the Credit Agreement will automatically and without notice or demand become immediately due and payable. As of September 27, 2020, the Company is in compliance with all the covenants of the Credit Agreement.

No amounts had been drawn under the Credit Facility as of September 27, 2020.

Note 10. Commitments and Contingencies

Operating Leases

The Company primarily leases office space, with various expiration dates through June 2029. Some of the leases include options to extend such leases for up to five years, and some include options to terminate such leases within one year. The terms of certain of the Company's leases provide for rental payments on a graduated scale. The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, accrued liabilities, and non-current operating lease liabilities in the unaudited condensed consolidated balance sheets. Leases with an initial term of 12 months or less are not recorded on the balance sheet. Fixed lease expense for lease payments are recognized in the unaudited condensed consolidated statements of operations on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred.

In connection with the leases for the Company's offices in San Jose, California and Richmond, Canada, the Company received tenant improvement allowances ("TIA") of \$3.5 million and \$450 thousand, respectively, in the second quarter of 2020 from lessors for certain improvements the Company made to the leased properties. The improvement made to the leased property in San Jose, California is considered as lessee-owned, and the Company recorded the improvement as a leasehold improvement within property and equipment, net and the TIA as a reduction to the ROU asset with the impact of the decrease recognized prospectively over the remaining lease term. The improvement made to the leased property in Richmond, Canada is considered as lessor-owned, and the Company recorded the improvement as a prepaid rent within prepaid expenses and other current assets and the TIA as a reduction to prepaid rent.

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The operating lease expense for the three and nine months ended September 27, 2020 and September 29, 2019 was as follows:

		Three Months Ended		Nine Months Ended	
		September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
Statements of Operations Location		(In thousands)			
Operating lease cost ⁽¹⁾	General and administrative	\$ 1,728	\$ 1,726	\$ 5,319	\$ 5,068

⁽¹⁾Includes short-term leases and variable lease costs which were immaterial.

Supplemental cash flow information related to operating leases for the three and nine months ended September 27, 2020 and September 29, 2019 was as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
(in thousands)				
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from operating leases	\$ 1,493	\$ 1,470	\$ 4,452	\$ 2,882
Right-of-use assets obtained in exchange for lease liabilities				
Operating leases	\$ —	\$ 439	\$ 461	\$ 22,172

Weighted average remaining lease term and weighted average discount rate related to operating leases as of September 27, 2020 were as follows:

Weighted average remaining lease term	7.1 years
Weighted average discount rate	5.69 %

The maturity of lease liabilities related to operating leases for each of the next five years and thereafter as of September 27, 2020 was as follows (in thousands):

2020 (Remaining three months)	\$ 1,505
2021	5,893
2022	5,735
2023	4,946
2024	4,449
Thereafter	14,672
Total lease payments	37,200
Less: interest ⁽¹⁾	(6,800)
Total	\$ 30,400
Accrued liabilities	\$ 4,376
Non-current operating lease liabilities	26,024
Total	\$ 30,400

⁽¹⁾Leases that commenced before November 5, 2019 were calculated using the Company's incremental borrowing rate on a collateralized basis plus LIBOR rate that closely matches contractual term of most leases. Leases that commenced after November 5, 2019 were calculated using the Company's borrowing rate defined in the Credit Agreement with Western Alliance Bank.

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The maturity of lease liabilities related to operating leases for each of the next five years and thereafter as of December 31, 2019 was as follows (in thousands):

2020	\$	5,660
2021		5,735
2022		5,589
2023		4,908
2024		4,450
Thereafter		14,669
Total lease payments		41,011
Less: interest ⁽¹⁾		(8,098)
Total	\$	32,913
Accrued liabilities	\$	3,912
Non-current operating lease liabilities		29,001
Total	\$	32,913

⁽¹⁾ Calculated using the Company's incremental borrowing rate on a collateralized basis plus LIBOR rate that closely matches contractual term of most leases.

Letters of Credit

In connection with the lease agreement for the headquarters located in San Jose, California, the Company executed a letter of credit with the landlord as the beneficiary. As of September 27, 2020 the Company had approximately \$3.6 million of unused letters of credit outstanding, of which \$3.1 million pertains to the lease arrangement in San Jose, California.

Purchase Obligations

The Company has entered into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of orders are cancellable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancellable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. As of September 27, 2020, the Company had approximately \$38.1 million in non-cancelable purchase commitments with suppliers. The Company establishes a loss liability for all products it does not expect to sell for which it has committed purchases from suppliers. As of September 27, 2020, the loss liability from committed purchases was \$3.0 million. From time to time the Company's suppliers procure unique complex components on the Company's behalf. If these components do not meet specified technical criteria or are defective, the Company should not be obligated to purchase the materials.

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Warranty Obligations

Changes in the Company's warranty liability, which is included in Accrued liabilities in the unaudited condensed consolidated balance sheets, were as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
	(In thousands)			
Balance at the beginning of the period	\$ 3,023	\$ 3,232	\$ 3,169	\$ 3,712
Provision for warranty obligation made during the period	—	364	—	292
Settlements made during the period	(455)	(193)	(601)	(601)
Balance at the end of the period	<u>\$ 2,568</u>	<u>\$ 3,403</u>	<u>\$ 2,568</u>	<u>\$ 3,403</u>

Litigation and Other Legal Matters

The Company is involved in disputes, litigation, and other legal actions, including, but not limited to, the matters described below. In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range, only if there is not a better estimate than any other amount within the range, as a component of legal expense within litigation reserves, net. The Company monitors developments in these legal matters that could affect the estimate the Company had previously accrued. In relation to such matters, the Company currently believes that there are no existing claims or proceedings that are likely to have a material adverse effect on its financial position within the next 12 months, or the outcome of these matters is currently not determinable. There are many uncertainties associated with any litigation, and these actions or other third-party claims against the Company may cause the Company to incur costly litigation and/or substantial settlement charges. In addition, the resolution of any intellectual property litigation may require the Company to make royalty payments, which could have an adverse effect in future periods. If any of those events were to occur, the Company's business, financial condition, results of operations, and cash flows could be adversely affected. The actual liability in any such matters may be materially different from the Company's estimates, which could result in the need to adjust the liability and record additional expenses.

Beginning on December 11, 2018, purported stockholders of Arlo Technologies, Inc. filed six putative securities class action complaints in the Superior Court of California, County of Santa Clara, and one complaint in the U.S. District Court for the Northern District of California against the Company and certain of its executives and directors. Some of these actions also name as defendants the underwriters in the Company's initial public offering ("IPO") and NETGEAR, Inc. ("NETGEAR"). The actions pending in state court are *Aversa v. Arlo Technologies, Inc., et al.*, No. 18CV339231, filed Dec. 11, 2018; *Pham v. Arlo Technologies, Inc. et al.*, No. 19CV340741, filed January 9, 2019; *Patel v. Arlo Technologies, Inc.*, No. 19CV340758, filed January 10, 2019; *Perros v. NetGear, Inc.*, No. 19CV342071, filed February 1, 2019; *Vardanian v. Arlo Technologies, Inc.*, No. 19CV342318, filed February 8, 2019; and *Hill v. Arlo Technologies, Inc. et al.*, No. 19CV343033, filed February 22, 2019. On April 26, 2019, the state court consolidated these actions as *In re Arlo Technologies, Inc. Shareholder Litigation*, No. 18CV339231 (the "State Action"). The action pending in federal court is *Wong v. Arlo Technologies, Inc. et al.*, No. 19-CV-00372 (the "Federal Action").

The plaintiffs in the State Action filed a consolidated complaint on May 1, 2019. The plaintiffs allege that the Company failed to adequately disclose quality control problems and adverse sales trends ahead of its IPO, violating the Securities Act of 1933, as amended. The complaint seeks unspecified monetary damages and other relief on behalf of investors who purchased Company common stock issued pursuant and/or traceable to the IPO.

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On June 21, 2019, the court stayed the State Action pending resolution of the Federal Action, given the substantial overlap between the claims. The court has set a case management conference for December 16, 2020, so the parties can provide an update regarding the Federal Action.

In the Federal Action, the court appointed a shareholder named Matis Nayman as lead plaintiff. On June 7, 2019, plaintiff filed an amended complaint. Plaintiff alleges violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, based on alleged materially false and misleading statements about the Company's sales trends and products. In the amended complaint, plaintiff sought to represent a class of persons who purchased or otherwise acquired the Company's common stock (i) during the period between August 3, 2018 through December 3, 2018 and/or (ii) pursuant to or traceable to the IPO. Plaintiff seeks class certification, an award of unspecified damages, an award of costs and expenses, including attorneys' fees, and other further relief as the court may deem just and proper.

On August 6, 2019, defendants filed a motion to dismiss. The court granted that motion, and plaintiff filed a second amended complaint. On June 12, 2020, plaintiff filed an unopposed motion for preliminary approval of a class action settlement for \$1.25 million. The settlement remains subject to further court approval. On September 24, 2020, the court entered an order preliminarily approving the settlement. The final approval hearing is scheduled for March 11, 2021.

As of September 27, 2020, the Company had accrued a loss contingency of \$1.25 million for the Federal Action, reflecting the amounts owed under the settlement agreement. In October 2020, the Company made a \$1.25 million payment to an escrow account administered by the court and plaintiff's counsel (the "Settlement Fund"). The Settlement Fund shall be deemed to be in the custody of the court and shall remain subject to the jurisdiction of the court until such time as the Settlement Fund is distributed pursuant to the settlement agreement and/or further order of the court.

In addition, to the State Action and the Federal Action, a purported stockholder named Leonard Pinto filed a tagalong derivative action on June 13, 2019 (the "Derivative Action") in the U.S. District Court for the Northern District of California. The action is brought on behalf of the Company against the majority of the Company's current directors. The complaint is based on the same alleged misconduct as the securities class actions but asserts claims for breach of fiduciary duty, waste of corporate assets, and violation of the Securities Exchange Act of 1934, as amended. On August 20, 2019, the court stayed the Derivative Action in deference to the Federal Action.

On April 15, 2020, a purported stockholder named David W. Foster filed a lawsuit under 8 Del. C. § 220 in the Delaware Court of Chancery. Plaintiff seeks inspection of corporate books and records to investigate the allegations underlying the State Actions and Federal Action. Plaintiff also seeks an order directing the Company to pay his costs and expenses. On June 30, 2020, the parties filed a stipulation to stay the case so that they could attempt to reach a negotiated resolution. On July 1, 2020, the court approved the stipulation. The parties have reached an agreement in principle to resolve the action and are working to resolve the remaining issues. The impact on the Company's financial statements is expected to be immaterial.

Indemnification of Directors and Officers

The Company, as permitted under Delaware law and in accordance with its bylaws, has agreed to indemnify its officers and directors for certain events or occurrences, subject to certain conditions, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that will enable it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of each indemnification agreement will be minimal. The Company had no liabilities recorded for these agreements as of September 27, 2020 and December 31, 2019.

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Indemnifications

Prior to the completion of the IPO, the Company historically participated in NETGEAR's sales agreements. In its sales agreements, NETGEAR typically agrees to indemnify its direct customers, distributors and resellers (the "Indemnified Parties") for any expenses or liability resulting from claimed infringements by NETGEAR's products of patents, trademarks or copyrights of third parties that are asserted against the Indemnified Parties, subject to customary carve-outs. The terms of these indemnification agreements are generally perpetual after execution of the agreement. The maximum amount of potential future indemnification is generally unlimited. From time to time, the Company receives requests for indemnity and may choose to assume the defense of such litigation asserted against the Indemnified Parties. The Company had no liabilities recorded for these agreements as of September 27, 2020 and December 31, 2019. In connection with the separation of the Company's business from NETGEAR (the "Separation"), and after July 1, 2018, certain sales agreements were transferred to the Company, and the Company has replaced certain shared contracts, which include similar indemnification terms.

In addition, pursuant to the master separation agreement and certain other agreements entered into with NETGEAR in connection with the Separation and the IPO, NETGEAR has agreed to indemnify the Company for certain liabilities. The master separation agreement provides for cross-indemnities principally designed to place financial responsibility for the obligations and liabilities of its business with the Company and financial responsibility for the obligations and liabilities of NETGEAR's business with NETGEAR. Under the intellectual property rights cross-license agreement entered into between the Company and NETGEAR, each party, in its capacity as a licensee, indemnifies the other party, in its capacity as a licensor, and its directors, officers, agents, successors and subsidiaries against any losses suffered by such indemnified party as a result of the indemnifying party's practice of the intellectual property licensed to such indemnifying party under the intellectual property rights cross-license agreement. Also, under the tax matters agreement entered into between the Company and NETGEAR, each party is liable for, and indemnifies the other party and its subsidiaries from and against any liability for, taxes that are allocated to the indemnifying party under the tax matters agreement. In addition, the Company has agreed in the tax matters agreement that each party will generally be responsible for any taxes and related amounts imposed on it or NETGEAR as a result of the failure of the Distribution, together with certain related transactions, to qualify as a transaction that is generally tax-free, for U.S. federal income tax purposes, under Sections 355 and 368(a)(1)(D) and certain other relevant provisions of the Code, to the extent that the failure to so qualify is attributable to actions, events or transactions relating to such party's respective stock, assets or business, or a breach of the relevant representations or covenants made by that party in the tax matters agreement. The transition services agreement generally provides that the applicable service recipient indemnifies the applicable service provider for liabilities that such service provider incurs arising from the provision of services other than liabilities arising from such service provider's gross negligence, bad faith or willful misconduct or material breach of the transition services agreement, and that the applicable service provider indemnifies the applicable service recipient for liabilities that such service recipient incurs arising from such service provider's gross negligence, bad faith or willful misconduct or material breach of the transition services agreement. Pursuant to the registration rights agreement, the Company has agreed to indemnify NETGEAR and its subsidiaries that hold registrable securities (and their directors, officers, agents and, if applicable, each other person who controls such holder under Section 15 of the Securities Act) registering shares pursuant to the registration rights agreement against certain losses, expenses and liabilities under the Securities Act, common law or otherwise. NETGEAR and its subsidiaries that hold registrable securities similarly indemnify the Company but such indemnification will be limited to an amount equal to the net proceeds received by such holder under the sale of registrable securities giving rise to the indemnification obligation.

Change in Control and Severance Agreements

The Company has entered into change in control and severance agreements with certain of its executive officers (the "Severance Agreements"). Pursuant to the Severance Agreements, upon a termination without cause or resignation with good reason, the individual would be entitled to (1) cash severance equal to (a) the individual's annual base salary and an additional amount equal to his or her target annual bonus (for the Chief Executive Officer) or (b) the individual's annual base salary (for other executive officers), (2) 12 months of health benefits continuation, and (3) accelerated

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vesting of any unvested time-based equity awards that would have vested during the 12 months following the termination date. Upon a termination without cause or resignation with good reason that occurs during the one month prior to or 12 months following a change in control, the individual would be entitled to (1) (a) cash severance equal to a multiple (2 times for the Chief Executive Officer and 1 times for other executive officers) of the sum of the individual's annual base salary and target annual bonus, (2) a number of months of health benefits continuation (24 months for the Chief Executive Officer and 12 months for other executive officers) and (3) vesting of all outstanding, unvested equity awards (for the Chief Executive Officer) and the vesting of all outstanding, unvested time-based equity awards (for other executive officers). Severance will be conditioned upon the execution and non-revocation of a release of claims. The Company had no liabilities recorded for these agreements as of September 27, 2020.

On June 15, 2020 (the "Retirement Date"), Christine Gorjanc retired as the Chief Financial Officer, principal financial officer and principal accounting officer of the Company. In connection with her retirement, the Company, NETGEAR and Ms. Gorjanc entered into a Separation Agreement and Release (the "Separation Agreement") pursuant to which Ms. Gorjanc received a \$15,000 cash payment and accelerated vesting of (i) 8,749 shares subject to Company stock options, (ii) 43,216 shares subject to Company restricted stock units, (iii) 2,897 shares subject to NETGEAR stock options and (iv) 15,000 shares subject to NETGEAR restricted stock units. The Board of Directors of the Company appointed Gordon Mattingly as the Company's Chief Financial Officer, principal financial officer and principal accounting officer, effective as of the Retirement Date. In connection with his appointment as the Company's Chief Financial Officer, the Company entered into a confirmatory employment letter (the "Employment Agreement") with Mr. Mattingly. Pursuant to the Employment Agreement, Mr. Mattingly will receive an annual base salary of \$383,000 and is eligible to receive an annual target bonus of 70% of his annual base salary. Mr. Mattingly will also continue to be eligible to participate in the Company's equity compensation plans and employee benefit plans available to other employees of the Company. The Company also entered into an updated change in control and severance agreement consistent with Mr. Mattingly's new role of Chief Financial Officer.

On May 2, 2019, the Company and Patrick J. Collins III, the Company's Senior Vice President of Products, entered into a Separation and Release Agreement (the "Separation Agreement") regarding Mr. Collins' separation from the Company, effective May 1, 2019. Pursuant to the Separation Agreement, Mr. Collins received cash severance equal to his annual base salary, 12 months of health benefits continuation and accelerated vesting of any of his unvested equity awards that would have vested during the 12 months following the termination date.

Environmental Regulation

The Company is required to comply and is currently in compliance with the European Union ("EU") and other Directives on the Restrictions of the use of Certain Hazardous Substances in Electrical and Electronic Equipment ("RoHS"), Waste Electrical and Electronic Equipment ("WEEE") requirements, Energy Using Product ("EuP") requirements, the REACH Regulation, Packaging Directive and the Battery Directive.

The Company is subject to various federal, state, local, and foreign environmental laws and regulations, including those governing the use, discharge, and disposal of hazardous substances in the ordinary course of its manufacturing process. The Company believes that its current manufacturing and other operations comply in all material respects with applicable environmental laws and regulations; however, it is possible that future environmental legislation may be enacted or current environmental legislation may be interpreted to create an environmental liability with respect to its facilities, operations, or products.

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Note 11. Employee Benefit Plans

The Company grants options and restricted stock units ("RSUs") under the 2018 Equity Incentive Plan (the "2018 Plan"), under which awards may be granted to all employees. Award vesting periods for this plan are generally three to four years. Options may be granted for periods of up to 10 years or such shorter term as may be provided in the applicable option agreement and at prices no less than 100% of the fair market value of the Company's common stock on the date of grant. Options granted under the 2018 Plan generally vest over four years, the first tranche at the end of 12 months and the remaining shares underlying the option vesting monthly over the remaining three years.

The following table sets forth the available shares for grant under the 2018 Plan as of September 27, 2020 and December 31, 2019:

	Number of Shares (In thousands)
Shares available for grant as of December 31, 2019	2,630
Additional authorized shares	3,031
Granted ⁽¹⁾	(7,331)
Forfeited / cancelled ⁽²⁾	3,345
Shares traded for taxes	1,252
Shares available for grant as of September 27, 2020	2,927

⁽¹⁾ Includes 2.0 million shares consisting of RSUs (50% of the grant), performance RSUs ("PSUs") (25% of the grant), and market-based performance RSUs ("MPSUs") (25% of the grant) granted to the Company's named executive officers ("NEOs") during the fiscal quarter ended June 28, 2020. Also includes 1.1 million immediately vested shares granted to employees for annual bonus in RSU form.

⁽²⁾ Includes (a) 1.4 million options granted in connection with the IPO ("IPO Options") that were voluntarily cancelled by the Company's Chief Executive Officer ("CEO") in January 2020 with no replacement award, (b) 0.1 million IPO Options granted to Ms. Gorjanc that were cancelled for not achieving performance milestones, (c) 0.2 million shares subject to the PSUs granted to the Company's NEOs that were cancelled as the performance milestone was not achieved, and (d) awards that were cancelled in connection with Ms. Gorjanc's separation from the Company (0.3 million IPO Options and 54 thousand shares subject to the MPSUs).

Additionally, the Company sponsors an Employee Stock Purchase Plan ("ESPP"), pursuant to which eligible employees may contribute up to 15% of compensation, subject to certain income limits, to purchase shares of the Company's common stock. The terms of the plan include a look-back feature that enables employees to purchase stock semi-annually at a price equal to 85% of the lesser of the fair market value at the beginning of the offering period or the purchase date. The duration of each offering period is generally six months, with the first offering period having commenced on February 16, 2019 and ended on August 15, 2019. As of September 27, 2020, approximately 1.1 million shares were available for issuance under the ESPP.

On March 3, 2020, the Company registered an aggregate of up to 3,788,756 shares of the Company's common stock on Registration Statement on Form S-8, including 3,031,005 shares issuable pursuant to the Company's 2018 Plan that were automatically added to the shares authorized for issuance under the 2018 Plan on January 1, 2020 pursuant to an "evergreen" provision contained in the 2018 Plan and 757,751 shares issuable pursuant to the Company's 2018 ESPP that were automatically added to the shares authorized for issuance under the 2018 ESPP on January 1, 2020 pursuant to an "evergreen" provision contained in the 2018 ESPP.

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Option Activity

The Company's stock option activity during the nine months ended September 27, 2020 was as follows:

	Number of shares (In thousands)	Weighted Average Exercise Price Per Share (In dollars)
Outstanding as of December 31, 2019 ⁽¹⁾	6,040	\$ 11.56
Granted	—	\$ —
Exercised	(4)	\$ 5.65
Forfeited / cancelled ⁽²⁾	(2,234)	\$ 14.95
Outstanding as of September 27, 2020	3,802	\$ 9.58
Vested and expected to vest as of September 27, 2020	3,802	\$ 9.58
Exercisable Options as of September 27, 2020 ⁽³⁾	3,268	\$ 8.88

- ⁽¹⁾ Includes IPO Options of 2.8 million shares. Tranches 1 to 5 granted to Mr. Collins were cancelled in connection with his separation from the Company in May 2019. Tranches 4 and 5 granted to the CEO were voluntarily forfeited in 2019 as the performance milestones for those tranches were not achieved, Tranches 1, 2 and 3 granted to the CEO were voluntarily forfeited in January 2020 with no replacement award. The performance milestones for Tranches 4 and 5 that were granted to Ms. Gorjanc were not met, hence, Tranche 4 was cancelled in 2019 and Tranche 5 was cancelled in June 2020. Tranches 1 to 3 granted to Ms. Gorjanc were cancelled in connection with her separation from the Company in June 2020.
- ⁽²⁾ Includes 1.4 million shares subject to the IPO Options that were voluntarily cancelled by the CEO in January 2020 with no replacement award, 0.1 million IPO Options granted to Ms. Gorjanc that were cancelled as the performance milestone was not achieved, and 0.3 million IPO Options that were cancelled in connection with Ms. Gorjanc's separation from the Company.
- ⁽³⁾ Includes 6 thousand options that were accelerated in connection with Ms. Gorjanc's separation from the Company.

NETGEAR stock option activity for Company employees during the nine months ended September 27, 2020 was as follows:

	Number of shares (In thousands)	Weighted Average Exercise Price Per Share (In dollars)
Outstanding as of December 31, 2019	205	\$ 25.94
Exercised	(139)	\$ 22.69
Forfeited / cancelled	(47)	\$ 36.73
Expired	—	\$ —
Outstanding as of September 27, 2020	19	\$ 22.95
Vested and expected to vest as of September 27, 2020	19	\$ 22.95
Exercisable Options as of September 27, 2020 ⁽¹⁾	13	\$ 20.39

- ⁽¹⁾ Includes 3 thousand options that were accelerated in connection with Ms. Gorjanc's separation from the Company.

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RSU Activity

The Company's RSU activity during the nine months ended September 27, 2020 was as follows:

	Number of shares	Weighted Average Grant Date Fair Value Per Share
	(In thousands)	(In dollars)
Outstanding as of December 31, 2019 ⁽¹⁾	7,851	\$ 6.50
Granted ⁽²⁾	7,331	\$ 3.01
Vested ⁽³⁾	(3,380)	\$ 6.29
Forfeited ⁽⁴⁾	(1,111)	\$ 4.66
Outstanding as of September 27, 2020	10,691	\$ 4.37

- ⁽¹⁾ Includes 0.8 million shares consisting of RSUs (50% of the grant), PSUs (25% of the grant) and MPSUs (25% of the grant) granted to the NEOs during the fiscal quarter ended September 29, 2019. The RSUs will vest in three equal annual installments during the period that begins on the RSU grant date. The PSUs will vest in three equal annual installments during the period that begins on the PSU grant date based on the extent to which a revenue milestone for the fiscal year ended December 31, 2019 is achieved. As of September 27, 2020, the shares subject to PSUs that were granted to the Company's NEOs were cancelled as the performance milestone was not achieved. The MPSUs will vest at the end of the three-year period that begins on the MPSU grant date based on performance of the Company's common stock relative to the Benchmark during the three-year period from the grant date. A positive 3.3x or negative 2.5x multiplier will be applied to the total shareholder returns ("TSR"), such that the number of shares vested will increase by 3.3% or decrease by 2.5% of the target numbers, for each 1% of positive or negative TSR relative to the Benchmark. In the event the Company's common stock performance is below negative 30% relative to the Benchmark, no shares will be vested. In no event will the number of shares vested exceed 200% of the target for that tranche. The shares subject to the MPSUs that were granted to Ms. Gorjanc were cancelled in connection with her separation from the Company during the fiscal quarter ended June 28, 2020. As of September 27, 2020, 200% of the outstanding MPSUs are expected to vest.
- ⁽²⁾ Includes 2.0 million shares consisting of RSUs (50% of the grant), PSUs (25% of the grant) and MPSUs (25% of the grant) granted to the NEOs during the fiscal quarter ended June 28, 2020. The RSUs will vest in three equal annual installments during the period that begins on the RSU grant date. The PSUs will vest in three equal annual installments during the period that begins on the PSU grant date based on the extent to which a cash balance milestone as of December 31, 2020 is achieved. As of September 27, 2020, 100% of the outstanding PSUs are expected to vest. The MPSUs will vest at the end of the three-year period that begins on the MPSU grant date based on performance of the Company's common stock relative to the Benchmark during the three-year period from the grant date. A positive 3.3x or negative 2.5x multiplier will be applied to the total shareholder returns ("TSR"), such that the number of shares vested will increase by 3.3% or decrease by 2.5% of the target numbers, for each 1% of positive or negative TSR relative to the Benchmark. In the event the Company's common stock performance is below negative 30% relative to the Benchmark, no shares will be vested. In no event will the number of shares vested exceed 200% of the target for that tranche. As of September 27, 2020, 200% of the outstanding MPSUs are expected to vest.
- Also includes 1.1 million immediately vested shares granted to employees for annual bonus in RSU form.
- ⁽³⁾ Includes 43 thousand shares subject to the RSUs that were accelerated in connection with Ms. Gorjanc's separation from the Company. Also includes 1.1 million immediately vested shares granted to employees for annual bonus in RSU form.
- ⁽⁴⁾ Includes 0.2 million shares subject to the PSUs granted to the Company's NEOs that were cancelled as the performance milestone was not achieved and 54 thousand shares subject to the MPSUs granted to Ms. Gorjanc that were cancelled in connection with her separation from the Company.

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NETGEAR RSU activity for Company employees during the nine months ended September 27, 2020 was as follows:

	Number of shares (In thousands)	Weighted Average Grant Date Fair Value Per Share (In dollars)
Outstanding as of December 31, 2019	278	\$ 36.14
Vested ⁽¹⁾	(116)	\$ 34.86
Forfeited	(21)	\$ 36.27
Outstanding as of September 27, 2020	141	\$ 37.18

⁽¹⁾ Includes 15 thousand shares subject to the RSUs that were accelerated in connection with Ms. Gorjanc's separation from the Company.

The Company determined the fair value of stock options and the shares offered under the ESPP using the Black-Scholes option pricing model as of the grant date. The following table sets forth the weighted average assumptions used to estimate the fair value of options granted and purchase rights granted under the ESPP for the three and nine months ended September 27, 2020 and September 29, 2019.

	Three Months Ended				Nine Months Ended			
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
	Stock Options		ESPP		Stock Options		ESPP	
Expected life (in years)	NA	NA	0.5	0.5	NA	6.3	0.5	0.5
Risk-free interest rate	NA	NA	0.86 %	2.49 %	NA	2.28 %	1.47 %	2.49 %
Expected volatility	NA	NA	99.6 %	97.6 %	NA	73.0 %	85.7 %	97.6 %
Dividend yield	—	—	—	—	—	—	—	—

The Company determined the fair value of the RSUs and PSUs using the closing price of the Company's common stock as of the grant date. For PSUs, stock-based compensation expense of performance milestone is recognized over the expected performance achievement period when the achievement becomes probable.

The Company utilized a Monte Carlo pricing model customized to the specific provisions of the 2018 Plan to value the MPSUs awards on the grant date. The fair value of the MPSUs granted in the fiscal quarters ended June 28, 2020 and September 29, 2019 was \$4.11 and \$4.14 per share, respectively. The assumptions used in this model to estimate fair value at the grant date are as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
Expected life	N/A	3.0	3.0	3.0
Risk-free interest rate	N/A	1.52 %	0.24 %	1.52 %
Expected volatility	N/A	65.1 %	69.3 %	65.1 %
Dividend yield	N/A	—	—	—
Stock Beta	N/A	0.30	0.48	0.30

Stock-Based Compensation Expense

The Company's employees have historically participated in NETGEAR's various stock-based plans, which are described below and represent the portion of NETGEAR's stock-based plans in which Company employees participated. The Company's unaudited condensed consolidated statements of income reflect compensation expense for these stock-based plans associated with the portion of NETGEAR's plans in which Company employees participated. The stock-

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based compensation expense for Company employees consist of the Company's RSUs, PSUs, MPSUs and stock options, NETGEAR RSUs and stock options granted to Company employees, and employees' annual bonus in RSU form. The following table sets forth the stock-based compensation expense included in the Company's unaudited condensed consolidated statements of operations during the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
	(In thousands)			
Cost of revenue	\$ 942	\$ 467	\$ 2,007	\$ 1,286
Research and development	2,870	1,569	6,259	4,501
Sales and marketing	1,160	791	2,895	2,722
General and administrative	4,029	2,392	15,177	6,752
Total stock-based compensation	<u>\$ 9,001</u>	<u>\$ 5,219</u>	<u>\$ 26,338</u>	<u>\$ 15,261</u>

The Company recognizes these compensation expense generally on a straight-line basis over the requisite service period of the award.

In January 2020, the IPO Options granted to the CEO were voluntarily forfeited with no replacement award. The cancellation was treated as a settlement for no consideration and all remaining unrecognized compensation cost of \$7.4 million was accelerated and recognized as stock-based compensation expense for the three months ended March 29, 2020.

In the second fiscal quarter of 2020, \$1.2 million of previously recognized compensation expense was reversed as a result of cancellation of unvested shares upon Ms. Gorjanc's separation from the Company. In addition, \$0.4 million of compensation expense was recognized for Ms. Gorjanc's accelerated vested shares upon her separation from the Company.

As of September 27, 2020, \$1.6 million of unrecognized compensation cost related to the Company's stock options was expected to be recognized over a weighted-average period of 1.4 years. \$31.1 million of unrecognized compensation cost related to unvested Company RSUs, PSUs and MPSUs was expected to be recognized over a weighted-average period of 2.6 years.

As of September 27, 2020, \$42 thousand of unrecognized compensation cost related to NETGEAR stock options for Company employees was expected to be recognized over a weighted-average period of 1.0 years. \$3.5 million of unrecognized compensation cost related to unvested NETGEAR RSUs for Company employees was expected to be recognized over a weighted-average period of 1.3 years.

Note 12. Income Taxes

The provision for income taxes for the three and nine months ended September 27, 2020 was \$0.1 million, or an effective tax rate of (0.7)%, and \$0.4 million, or an effective tax rate of (0.5)%, respectively. The income tax provision for the three and nine months ended September 29, 2019 was \$0.3 million, or an effective tax rate of (0.9)%, and \$0.9 million, or an effective tax rate of (0.8)%, respectively. During the three and nine months ended September 27, 2020, the Company sustained lower domestic book losses than the same periods in the prior year. Consistent with the prior year, the Company maintained a full valuation allowance on its domestic federal and state deferred tax assets and did not record a tax benefit on these deferred tax assets because of uncertainty about its future realizability of deferred tax assets. The Company's provision for income taxes was primarily attributable to income taxes on foreign earnings. The decrease in provision for income taxes for the three and nine months ended September 27, 2020, compared to the prior year periods was primarily due to lower foreign earnings in fiscal 2020.

Note 13. Net Income (Loss) Per Share

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Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Potentially dilutive common shares, such as common shares issuable upon exercise of stock options and vesting of restricted stock awards are typically reflected in the computation of diluted net income (loss) per share by application of the treasury stock method. For certain periods presented, due to the net losses reported, these potentially dilutive securities were excluded from the computation of diluted net loss per share, since their effect would be anti-dilutive.

Net loss per share for the three and nine months ended September 27, 2020 and September 29, 2019 were as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
(In thousands, except per share data)				
Numerator:				
Net loss	\$ (17,459)	\$ (30,590)	\$ (86,041)	\$ (105,566)
Denominator:				
Weighted average common shares - basic	78,662	75,337	77,705	74,831
Potentially dilutive common share equivalent	—	—	—	—
Weighted average common shares - dilutive	<u>78,662</u>	<u>75,337</u>	<u>77,705</u>	<u>74,831</u>
Basic net loss per share	<u>\$ (0.22)</u>	<u>\$ (0.41)</u>	<u>\$ (1.11)</u>	<u>\$ (1.41)</u>
Diluted net loss per share	<u>\$ (0.22)</u>	<u>\$ (0.41)</u>	<u>\$ (1.11)</u>	<u>\$ (1.41)</u>
Anti-dilutive employee stock-based awards, excluded	5,958	10,287	7,526	10,114

Note 14. Segment and Geographic Information

Segment Information

The Company operates as one operating and reportable segment. The Company has identified its CEO as the Chief Operating Decision Maker (“CODM”). The CODM reviews financial information presented on a combined basis for purposes of allocating resources and evaluating financial performance.

Geographic Information

The Company conducts business across three geographic regions: Americas, EMEA and APAC. Revenue consists of gross product shipments and service revenue, less allowances for estimated sales returns, price protection, end-user customer rebates and other channel sales incentives deemed to be a reduction of revenue per the authoritative guidance for revenue recognition, net changes in deferred revenue, and gains or losses from hedging. For reporting purposes, revenue by geography is generally based upon the ship-to location of the customer for device sales and device location for service sales.

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The following table shows revenue by geography for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
(In thousands)				
Americas				
United States (“U.S.”)	\$ 73,826	\$ 81,441	\$ 166,273	\$ 184,733
Americas (excluding U.S.)	2,035	4,121	10,717	9,759
EMEA	28,010	13,002	46,846	37,370
APAC	6,365	7,552	18,482	15,732
Total revenue	<u>\$ 110,236</u>	<u>\$ 106,116</u>	<u>\$ 242,318</u>	<u>\$ 247,594</u>

The Company’s Property and equipment, net are located in the following geographic locations:

	As of	
	September 27, 2020	December 31, 2019
(In thousands)		
United States (“U.S.”)	\$ 13,097	\$ 17,100
Americas (excluding U.S.)	691	904
EMEA	250	316
China	2,095	2,089
APAC (excluding China)	699	943
Total property and equipment, net	<u>\$ 16,832</u>	<u>\$ 21,352</u>

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

Forward-looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "Securities Act") Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the Private Securities Litigation Reform Act of 1995. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, the words "believes," "anticipates," "plans," "expects," "intends," "could," "may," "will," and similar expressions are intended to identify forward-looking statements, including statements concerning our business and the expected performance characteristics, specifications, reliability, market acceptance, market growth, specific uses, user feedback, market position of our products and technology and the potential adverse impact of the COVID-19 pandemic on our business and operations. Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in "Part II—Item 1A—Risk Factors" and "Liquidity and Capital Resources" below. All forward-looking statements in this document are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements. The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes contained in this quarterly report and the audited financial statements and notes thereto as of and for the year ended December 31, 2019 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K, as amended, filed by us with the SEC. Unless expressly stated or the context otherwise requires, the terms "we," "our," "us," "the Company," and "Arlo" refer to Arlo Technologies, Inc. and our subsidiaries.

Business and Executive Overview

Arlo combines an intelligent cloud infrastructure and mobile app with a variety of smart connected devices that transform the way people experience the connected lifestyle. Our cloud-based platform provides users with visibility, insight and a powerful means to help protect and connect in real-time with the people and things that matter most, from any location with a Wi-Fi or a cellular connection. Since the launch of our first product in December 2014, we have shipped approximately 18.0 million smart connected devices, and, as of September 27, 2020, our smart platform had approximately 4.8 million cumulative registered accounts across more than 100 countries around the world.

We conduct business across three geographic regions—the Americas; Europe, Middle-East and Africa ("EMEA"); and Asia Pacific ("APAC") and we primarily generate revenue by selling devices through retail, wholesale distribution, wireless carrier channels, security channels, Arlo online store and paid subscription services. International revenue was 33.0% and 23.3% of our revenue for the three months ended September 27, 2020 and September 29, 2019, respectively, and 31.4% and 25.4% of our revenue for the nine months ended September 27, 2020 and September 29, 2019, respectively.

For the three months ended September 27, 2020 and September 29, 2019, we generated revenue of \$110.2 million and \$106.1 million, respectively, representing a year-over-year increase of 3.9%. Loss from operations was \$18.0 million for the three months ended September 27, 2020 and \$31.1 million for the three months ended September 29, 2019. For the nine months ended September 27, 2020 and September 29, 2019, we generated revenue of \$242.3 million and \$247.6 million, respectively, representing a year-over-year decline of 2.1%. Loss from operations was \$89.2 million for the nine months ended September 27, 2020 and \$107.0 million for the nine months ended September 29, 2019.

Our goal is to continue to develop innovative, world-class connected lifestyle solutions to expand and further monetize our current and future user and subscriber bases. We believe that the growth of our business is dependent on many factors, including our ability to innovate and launch successful new products on a timely basis and grow our installed base, to increase subscription-based recurring revenue, to invest in brand awareness and channel partnerships and to continue our global expansion. We expect to maintain our investment in research and development going forward as we continue to introduce new and innovative products and services to enhance the Arlo platform.

Key Business Metrics

In addition to the measures presented in our unaudited condensed consolidated financial statements, we use the following key metrics to evaluate our business, measure our performance, develop financial forecasts and make strategic decisions. In 2019, management's incentive compensation was partially determined using certain of these key business metrics. We believe these key business metrics provide useful information by offering the ability to make more meaningful period-to-period comparisons of our on-going operating results and a better understanding of how management plans and measures our underlying business. Our key business metrics may be calculated in a manner different from the same key business metrics used by other companies. We regularly review our processes for calculating these metrics, and from time to time we may discover inaccuracies in our metrics or make adjustments to better reflect our business or to improve their accuracy, including adjustments that may result in the recalculation of our historical metrics. We believe that any such inaccuracies or adjustments are immaterial unless otherwise stated.

	Three Months Ended		Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	September 29, 2019
(In thousands, except percentage data)					
Cumulative registered accounts	4,774	29.3 %	3,691	4,774	3,691
Cumulative paid accounts	356	68.7 %	211	356	211
Devices shipped for the period	978	(14.1)%	1,138	2,136	2,718

Cumulative Registered Accounts. We believe that our ability to increase our user base is an indicator of our market penetration and growth of our business as we continue to expand and innovate our Arlo platform. We define our registered accounts at the end of a particular period as the number of unique registered accounts on the Arlo platform as of the end of such particular period. The number of registered accounts does not necessarily reflect the number of end-users on the Arlo platform, as one registered account may be used by multiple people. We changed our definition from registered users to registered accounts starting in the fourth quarter ended December 31, 2019 due to the Verisure transaction. Verisure will own the registered accounts but we will continue to provide services to these European customers under the Verisure Agreements.

Cumulative Paid Accounts. Paid accounts worldwide measured as any account where a subscription to a paid service is being collected (either by Arlo or by Arlo's customers or channel partners), plus paid service plans of a duration of more than 3 months bundled with products (such bundles being counted as a paid account after 90 days have elapsed from the date of registration). In the fourth quarter ended December 31, 2019, we redefined paid subscribers as paid accounts to include customers that were transferred to Verisure as part of the disposal of our commercial operations in Europe, because we will continue to provide services to these European customers and receive payments associated with them, under the Verisure Agreements.

Devices Shipped. Devices shipped represents the number of Arlo cameras, lights, and doorbells that are shipped to our customers during a period. Devices shipped does not include shipments of Arlo accessories and Arlo base stations, nor does it take into account returns of Arlo cameras, lights, and doorbells. The growth rate of our revenue is not necessarily correlated with our growth rate of devices shipped, as our revenue is affected by a number of other variables, including but not limited to returns from customers, end-user customer rebates and other channel sales incentives deemed to be a reduction of revenue per the authoritative guidance for revenue recognition, sales of accessories, and premium services, the types of Arlo products sold during the relevant period and the introduction of new product offerings that have different U.S. manufacturer's suggested retail prices.

Impact of COVID-19

On March 11, 2020, the World Health Organization announced that COVID-19, a respiratory illness, caused by a novel coronavirus, is a pandemic. COVID-19 has spread to many of the countries in which we, our customers, our suppliers and our other business partners conduct business. Governments in affected regions have implemented, and may continue to implement, safety precautions which include quarantines, travel restrictions, business closures, cancellations of

public gatherings and other measures as they deem necessary. Many organizations and individuals, including the Company and its employees are taking additional steps to avoid or reduce infection, including limiting travel and staying home from work. These measures are disrupting normal business operations both in and outside of affected areas and have had significant negative impacts on businesses and financial markets worldwide. We anticipate that our financial results could be adversely impacted due to:

- temporary closure or decrease in foot traffic to our major customers' retail stores and shift of focus to essential goods distribution;
- disruption to our supply chain caused by delayed delivery of components from our third-party manufacturers and other suppliers located in regions affected by COVID-19;
- deferment of customer spending due to economic uncertainty;
- decreased productivity due to travel bans, work-from-home policies or shelter in place orders; and
- a slow-down in the global economy or a credit crisis.

The onset of the COVID-19 pandemic started to affect our product shipments in the second quarter of 2020 due to our major customers' retail stores facing temporary closures and decrease in foot traffic, certain of our customers shifting focus to essential goods distribution, and other uncertainties caused by the pandemic. The decline in product shipments continued throughout the third quarter of 2020. As of September 27, 2020, our Americas retail channel inventory declined to 8.5 weeks compared to 13.5 weeks as of September 29, 2019 due to disruption to our sales channel. This has contributed to a decline in net revenue in Americas by 11.3% and 9.0%, compared to the three and nine months ended September 29, 2019, respectively. At the same time, we saw a significant increase in freight-in expense of 41.2% and 84.9%, compared to the three and nine months ended September 29, 2019, respectively, as a result of higher airfreight rates.

While this is expected to be temporary, the current circumstances are dynamic and the future impacts of COVID-19 on our business operations, including the duration and impact on overall customer demand, cannot be reasonably estimated at this time. Our priorities and actions during the COVID-19 pandemic are focused on protecting the health and safety of all those we serve, our employees, our customers, our suppliers and our communities, including implementing early and continuous updates to our health and safety policies and processes. We have successfully migrated all but a limited number of our global workforce to work remotely while local and state governments have imposed shelter-in-place orders in the United States and around the world. We are focused on providing our team with the resources that they need to meet the needs of our customers and deliver new innovations to the markets we serve, despite challenges introduced by the COVID-19 pandemic. We continue to work with our suppliers to address any supply chain disruptions, which might include larger component backlogs, travel restrictions and logistics changes that can impact our operations. As a result, we could experience material charges from potential adjustments of the carrying value of our inventories and trade receivables, impairment charges on our long-lived assets, intangible assets and goodwill, and changes in the effectiveness of the Company's hedging instruments, among others. We also anticipate that COVID-19 could continue to reduce our revenues and increase product and service costs and operating expenses for the remainder of fiscal 2020.

We are focused on navigating these recent challenges presented by COVID-19 through preserving our liquidity and managing our cash flow through taking preemptive action to enhance our ability to meet our short-term liquidity needs. These actions include, but are not limited to, proactively managing working capital by closely monitoring customers' credit and collections, renegotiating payment terms with third-party manufacturers and key suppliers, closely monitoring inventory levels and purchases against forecasted demand, reducing or eliminating non-essential spending, and deferment of salary increases and hiring. We continue to monitor this rapidly developing situation and may, as necessary, reduce expenditures further, borrow under our revolving credit facility, or pursue other sources of capital that may include other forms of external financing in order to maintain our cash position and preserve financial flexibility in response to the uncertainty in the United States and global markets resulting from the COVID-19 pandemic.

Results of Operations

We operate as one operating and reportable segment. The following table sets forth, for the periods presented, the unaudited condensed consolidated statements of operations data, which we derived from the accompanying unaudited condensed consolidated financial statements:

	Three Months Ended				Nine Months Ended			
	September 27, 2020		September 29, 2019		September 27, 2020		September 29, 2019	
(In thousands, except percentage data)								
Revenue:								
Products	\$ 91,271	82.8 %	\$ 94,306	88.9 %	\$ 191,597	79.1 %	\$ 213,359	86.2 %
Services	18,965	17.2 %	11,810	11.1 %	50,721	20.9 %	34,235	13.8 %
Total revenue	110,236	100.0 %	106,116	100.0 %	242,318	100.0 %	247,594	100.0 %
Cost of revenue:								
Products	79,107	71.9 %	88,755	83.6 %	182,481	75.3 %	206,878	83.6 %
Services	9,720	8.8 %	6,858	6.5 %	28,986	12.0 %	18,618	7.5 %
Total cost of revenue	88,827	80.6 %	95,613	90.1 %	211,467	87.3 %	225,496	91.1 %
Gross profit	21,409	19.4 %	10,503	9.9 %	30,851	12.7 %	22,098	8.9 %
Operating expenses:								
Research and development	15,436	14.0 %	16,701	15.7 %	44,871	18.5 %	52,456	21.2 %
Sales and marketing	12,720	11.5 %	13,657	12.9 %	35,471	14.6 %	42,389	17.1 %
General and administrative	11,137	10.1 %	11,062	10.4 %	39,758	16.4 %	32,512	13.1 %
Separation expense	77	0.1 %	137	0.1 %	238	0.1 %	1,760	0.7 %
Gain on sale of business	—	—	—	—	(292)	— %	—	—
Total operating expenses	39,370	35.7 %	41,557	39.2 %	120,046	49.5 %	129,117	52.1 %
Loss from operations	(17,961)	(16.3)%	(31,054)	(29.3)%	(89,195)	(36.8)%	(107,019)	(43.2)%
Interest income	74	0.1 %	596	0.6 %	760	0.3 %	2,170	0.9 %
Other income (expense), net	543	0.5 %	154	0.1 %	2,837	1.3 %	138	0.1 %
Loss before income taxes	(17,344)	(15.7)%	(30,304)	(28.6)%	(85,598)	(35.3)%	(104,711)	(42.3)%
Provision for income taxes	115	0.1 %	286	0.3 %	443	0.2 %	855	0.2 %
Net loss	\$ (17,459)	(15.8)%	\$ (30,590)	(28.8)%	\$ (86,041)	(35.5)%	\$ (105,566)	(42.6)%

Revenue

Our gross revenue consists primarily of sales of devices, prepaid and paid subscription service revenue and NRE service revenue from Verisure. We generally recognize revenue from product sales at the time the product is shipped and transfer of control from us to the customer occurs. Our prepaid services primarily pertain to devices which are sold with our Arlo prepaid services offering, providing users with the ability to store and access data for up to five cameras for a rolling seven-day period. Prepaid services also include one year of Arlo Smart bundled with our Arlo Ultra products launched in early 2019, and three-month free subscription for Arlo Smart services for our Arlo Pro 3 products launched in late September 2019, Arlo Video Doorbell launched in late November 2019, Arlo Floodlight camera launched in May 2020, Arlo Essential Spotlight camera launched in late June 2020, and the latest version of Arlo Ultra which started shipping in June 2020. Upon device shipment, we attribute a portion of the sales price to the prepaid service, deferring this revenue at the outset and subsequently recognizing it ratably over the estimated useful life of the device or free trial period, as applicable. Our paid subscription services relate to sales of subscription plans to our registered accounts. Our NRE service revenue relates to the development services under the NRE arrangement with Verisure discussed in Note 4.

Our revenue consists of gross revenue, less end-user customer rebates and other channel sales incentives deemed to be a reduction of revenue per the authoritative guidance for revenue recognition, allowances for estimated sales returns, price protection, and net changes in deferred revenue. A significant portion of our marketing expenditure is with customers and is deemed to be a reduction of revenue under authoritative guidance for revenue recognition.

Under the Supply Agreement, Verisure became the exclusive distributor of our products in Europe for all channels, and will non-exclusively distribute our products through its direct channels globally. We expect that our revenue and profitability in Europe will improve over the lifetime of the Supply Agreement. Refer to Note 4, *Disposal of business*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q for a complete discussion of the Supply Agreement.

We conduct business across three geographic regions: Americas, EMEA, and APAC. We generally base revenue by geography on the ship-to location of the customer for device sales and device location for service sales.

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Americas	\$ 75,861	(11.3)%	\$ 85,562	\$ 176,990	(9.0)%	\$ 194,492
Percentage of revenue	68.8 %		80.6 %	73.0 %		78.6 %
EMEA	28,010	115.4 %	13,002	46,846	25.4 %	37,370
Percentage of revenue	25.4 %		12.3 %	19.3 %		15.1 %
APAC	6,365	(15.7)%	7,552	18,482	17.5 %	15,732
Percentage of revenue	5.8 %		7.1 %	7.6 %		6.4 %
Total revenue	<u>\$ 110,236</u>	<u>3.9 %</u>	<u>\$ 106,116</u>	<u>\$ 242,318</u>	<u>(2.1)%</u>	<u>\$ 247,594</u>

Revenue for the three months ended September 27, 2020 increased 3.9%, compared to the prior year period. The increase was primarily driven by higher service revenue and less provisions for sales returns and marketing expenditures that are deemed to be a reduction of revenue, partially offset by a decrease in product shipments as a result of disruption to our sales channels due to the COVID-19 pandemic. Revenue for the nine months ended September 27, 2020 decreased 2.1%, compared to the prior year period. The decrease was primarily driven by a decrease in product shipments as a result of disruption to our sales channels due to the COVID-19 pandemic, partially offset by an increase in service revenue and less provisions for sales returns and marketing expenditures that are deemed to be a reduction of revenue.

Service revenue increased by \$7.2 million, or 60.6%, and \$16.5 million, or 48.2%, for the three and nine months ended September 27, 2020 compared to the prior year periods, respectively, due to increased paid accounts compared to the prior year periods and recognition of NRE and other incremental service revenue of \$3.2 million and \$8.1 million from Verisure in three and nine months ended September 27, 2020, respectively.

Cost of Revenue

Cost of revenue consists of both product costs and costs of service. Product costs primarily consist of: the cost of finished products from our third-party manufacturers; overhead costs, including purchasing, product planning, inventory control, warehousing and distribution logistics, third-party software licensing fees, inbound freight, warranty costs associated with returned goods, write-downs for excess and obsolete inventory, royalties to third parties; and amortization expense of certain acquired intangibles. Cost of service consists of costs attributable to the provision and maintenance of our cloud-based platform, including personnel, storage, security and computing, as well as NRE service costs incurred under the Verisure NRE arrangement.

Our cost of revenue as a percentage of revenue can vary based upon a number of factors, including those that may affect our revenue set forth above and factors that may affect our cost of revenue, including, without limitation: product mix, sales channel mix, registered accounts' acceptance of paid subscription service offerings, fluctuation in foreign exchange rates and changes in our cost of goods sold due to fluctuations in prices paid for components, net of vendor rebates, cloud platform costs, warranty and overhead costs, inbound freight and duty product conversion costs, charges for excess or obsolete inventory, and amortization of acquired intangibles. We outsource our manufacturing, warehousing, and distribution logistics. We also outsource certain components of the required infrastructure to support our

cloud-based back-end IT infrastructure. We believe this outsourcing strategy allows us to better manage our product and services costs and gross margin.

The following table presents cost of revenue and gross margin for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Cost of revenue:						
Products	\$ 79,107	(10.9)%	\$ 88,755	\$ 182,481	(11.8)%	\$ 206,878
Services	9,720	41.7 %	6,858	28,986	55.7 %	18,618
Total cost of revenue	<u>\$ 88,827</u>	<u>(7.1)%</u>	<u>\$ 95,613</u>	<u>\$ 211,467</u>	<u>(6.2)%</u>	<u>\$ 225,496</u>

Cost of revenue decreased for the three and nine months ended September 27, 2020, primarily due to the decrease in product revenue and overhead costs, partially offset by higher service costs and excess and obsolete inventory provision compared to the prior year periods. The increase in service costs is in line with the service revenue growth and due to our continued investment in our cloud service offerings to improve our customer experience and to enhance our security profile, as well as Verisure NRE service costs. The increase in excess and obsolete inventory provision reflects lower expected future demand for certain older product lines for the nine months ended September 27, 2020 as we transition to newer technologies.

Gross Margin

The following table presents gross margin for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 27, 2020	September 29, 2019	September 27, 2020	September 29, 2019
(In thousands, except percentage data)				
Gross profit:				
Products	\$ 12,164	\$ 5,551	\$ 9,116	\$ 6,481
Services	9,245	4,952	21,735	15,617
Total gross profit	<u>\$ 21,409</u>	<u>\$ 10,503</u>	<u>\$ 30,851</u>	<u>\$ 22,098</u>
Gross profit percentage:				
Products	13.3 %	5.9 %	4.8 %	3.0 %
Services	48.7 %	41.9 %	42.9 %	45.6 %
Total gross profit percentage	19.4 %	9.9 %	12.7 %	8.9 %

Product margin increased for the three and nine months ended September 27, 2020, compared to the prior year periods, primarily due to a decrease in provisions for sales returns and marketing expenditures that are deemed to be a reduction of revenue, partially offset by higher excess and obsolete inventory provision.

Service margin increased for the three months ended September 27, 2020, compared to the prior year period, primarily due to an increase in paid service revenue and cost optimizations implemented. Service margin decreased for the nine months ended September 27, 2020, compared to the prior year period, primarily due to higher investment in our cloud service offerings and lower gross margin on the NRE service revenue associated with the Verisure NRE arrangement.

Operating Expenses

Research and Development

Research and development expense consists primarily of personnel-related expense, safety, security, regulatory services and testing, other research and development consulting fees, and corporate IT and facilities overhead. We recognize research and development expense as it is incurred. We have invested in and expanded our research and development organization to enhance our ability to introduce innovative products and services. We believe that innovation and technological leadership are critical to our future success, and we are committed to continuing a significant level of research and development to develop new technologies, products, and services, including our hardware devices, cloud-based software, AI-based algorithms, and machine learning capabilities. We expect research and development expense to stay relatively flat in absolute dollars for the remainder of fiscal 2020 as we manage our expenses while continuing to develop new product and service offerings to support the connected lifestyle market.

The following table presents research and development expense for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Research and development expense	\$ 15,436	(7.6)%	\$ 16,701	\$ 44,871	(14.5)%	\$ 52,456

Research and development expense decreased for the three months ended September 27, 2020, compared to the prior year period, due to decreases of \$1.2 million in corporate IT and facility overhead, partially offset by increases of \$0.6 million in personnel-related expenditures and \$0.6 million in expenses related to outside professional services. Also, certain research and development expenses amounting to \$1.2 million were attributed to the Verisure NRE arrangement in fiscal 2020, and are classified as cost of service revenue. Research and development expense decreased for the nine months ended September 27, 2020, compared to the prior year period, due to decreases of \$2.4 million in personnel-related expenses primarily due to the reduction in force implemented in the last quarter of 2019, and \$3.2 million in corporate IT

and facility overhead, partially offset by increase of \$1.3 million in expenses related to outside professional services. Also, contributing to the reduction in Research and development expense, various research and development expenses amounting to \$3.1 million were attributed to the Verisure NRE arrangement, and are classified as cost of service revenue in fiscal 2020.

Sales and Marketing

Sales and marketing expense consists primarily of personnel expense for sales and marketing staff; technical support expense; advertising; trade shows; corporate communications and other marketing expense; product marketing expense; IT and facilities overhead; and outbound freight costs. We expect our sales and marketing expense to fluctuate for the foreseeable future based on the seasonality of our business, the growth of our online store, and the extent to which we invest in marketing to drive awareness of our brand and drive demand for our products.

The following table presents sales and marketing expense for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Sales and marketing expense	\$ 12,720	(6.9)%	\$ 13,657	\$ 35,471	(16.3)%	\$ 42,389

Sales and marketing expense decreased for the three months ended September 27, 2020, compared to the prior year period, primarily due to decreases in personnel-related expenses of \$1.1 million as a result of a general reduction of headcount within sales and marketing as well as the transfer of our European sales and marketing on December 30, 2019 to Verisure coupled with a reduction in travel related expenses as a result of COVID-19 restrictions. Sales and marketing expense decreased for the nine months ended September 27, 2020, compared to the prior year period, primarily due to decreases in personnel-related expenses of \$4.3 million, marketing expenditures of \$1.4 million and corporate IT and facility overhead of \$1.2 million as a result of a general reduction of headcount within sales and marketing as well as the transfer of our European sales and marketing on December 30, 2019 to Verisure coupled with a reduction in travel related expense as a result of COVID-19 restrictions.

General and Administrative

General and administrative expense consists primarily of personnel-related expense for certain executives, finance and accounting, investor relations, human resources, legal, information technology, professional fees, corporate IT and facilities overhead, strategic initiative expense, and other general corporate expense. We expect our general and administrative expense to stay relatively flat in absolute dollars. However, we also expect our general and administrative expense to fluctuate as a percentage of our revenue in future periods based on fluctuations in our revenue and the timing of such expense.

The following table presents general and administrative expense for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
General and administrative expense	\$ 11,137	0.7 %	\$ 11,062	\$ 39,758	22.3 %	\$ 32,512

General and administrative expense increased for the three months ended September 27, 2020, compared to the prior year period, primarily due to higher personnel-related expenditures of \$1.3 million, partially offset by lower costs of \$0.9 million in legal and professional services. General and administrative expense increased for the nine months ended September 27, 2020, compared to the prior year period, primarily due to higher personnel-related expenditures of \$7.5 million, as a result of the \$7.4 million stock-based compensation expense recognized for the voluntary forfeiture of our CEO's IPO Options in January 2020, partially offset by the reversal of the previously recognized stock-based compensation expense amounting to \$1.2 million of unvested IPO Options and RSU upon separation of Ms. Gorjanc in June 2020, and

\$0.8 million of Verisure transaction costs recognized in 2020, partially offset by lower costs of \$0.8 million in legal and professional services.

Separation Expense

Separation expense consists primarily of costs associated with our separation from NETGEAR, including third-party advisory, consulting, legal and professional services for separation matters including IPO-related litigation, IT-related expenses directly related to our separation from NETGEAR, and other items that are incremental and one-time in nature. To operate as a standalone company, we have incurred separation costs. The significant reduction during the three and nine months ended September 27, 2020 was as a result of the substantial completion of our Separation from NETGEAR effective December 31, 2018.

The following table presents separation expense for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Separation expense	\$ 77	(43.8)%	\$ 137	\$ 238	(86.5)%	\$ 1,760

Gain on sale of business

The following table presents gain on sale of business for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Gain on sale of business	\$ —	**	\$ —	\$ (292)	**	\$ —

**Percentage change not meaningful

In the fourth quarter of 2019, we sold our commercial operations in Europe which resulted in a gain on sale of business. In the first quarter of 2020, we recognized an additional gain of \$292 thousand as a result of the final working capital adjustment. There was no gain or loss for the three months ended September 27, 2020 and the three and nine months ended September 29, 2019. Refer to Note 4, *Disposal of business*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q for a complete discussion of this disposal.

Interest Income and Other Income (Expense), Net

The following table presents other income (expense), net for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 27, 2020	% Change	September 29, 2019	September 27, 2020	% Change	September 29, 2019
(In thousands, except percentage data)						
Interest income	\$ 74	**	\$ 596	\$ 760	**	\$ 2,170
Other income (expense), net	\$ 543	**	\$ 154	\$ 2,837	**	\$ 138

**Percentage change not meaningful.

Our interest income was primarily earned from our short-term investments and cash and cash equivalents. We expect our interest income in absolute dollars to decrease as we use up our short-term investments and cash and cash equivalents to fund our operations, while interest rates have also declined.

Other income (expense), net, increased for the three months ended September 27, 2020, compared to the prior year period primarily due to Verisure TSA income of \$0.9 million recognized in 2020, partially offset by a decrease of \$0.4 million in fair value remeasurement of liability-classified awards for employees transferred to Verisure in December 2019 and a decrease of \$0.2 million due to losses in foreign currency hedging contracts. Other income (expense), net, increased

for the nine months ended September 27, 2020, compared to the prior year period primarily due to Verisure TSA income of \$3.0 million recognized in 2020.

Provision for Income Taxes

	Three Months Ended		September 29, 2019		September 27, 2020		September 29, 2019	
	September 27, 2020	% Change	September 29, 2019		September 27, 2020	% Change	September 29, 2019	
(In thousands, except percentage data)								
Provision for income taxes	\$ 115	(59.8)%	\$ 286		\$ 443	(48.2)%	\$ 855	
Effective tax rate	(0.7) %		(0.9) %		(0.5) %		(0.8) %	

The Company's provision for income taxes was primarily attributable to income taxes on foreign earnings. The decrease in provision for income taxes for the three and nine months ended September 27, 2020, compared to the prior year periods was primarily due to lower foreign earnings in 2020. Losses incurred predominantly in the U.S. continue to be subject to a full valuation allowance.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was enacted by the United States. The CARES Act did not have a material impact on the Company's provision for income taxes for the three and nine months ended September 27, 2020.

Liquidity and Capital Resources

We have a history of losses and may continue to incur operating and net losses for the foreseeable future. As of September 27, 2020, our accumulated deficit was \$217.6 million.

Our principal sources of liquidity are cash, cash equivalents and short-term investments. Short-term investments are marketable government securities with an original maturity or a remaining maturity at the time of purchase of greater than three months and no more than 12 months. The marketable securities are held in our company's name with a high quality financial institution, which acts as our custodian and investment manager. As of September 27, 2020, we had cash, cash equivalents and short-term investments totaling \$193.6 million. 6.3% of our cash and cash equivalents were held outside of the U.S. Starting in 2018, as a result of legislation enacted in 2017, informally titled the Tax Cuts and Jobs Act (the "Tax Act"), due to the one-time transition tax on un-repatriated earnings, the tax impact would generally be immaterial should we repatriate our cash from foreign earnings. The cash and cash equivalents balance outside of the U.S. is subject to fluctuation based on the settlement of intercompany balances. In November 2019, we entered into a business financing agreement with Western Alliance Bank providing for a credit facility to up to \$40.0 million and as of September 27, 2020, we have not borrowed against this credit facility. Refer to Note 9. *Debt* in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q for further details on such business financing agreement.

Based on our current plans, the business financing agreement with Western Alliance Bank, and market conditions, we believe that such sources of liquidity will be sufficient to satisfy our anticipated cash requirements for at least the next 12 months. However, in the future we may require or desire additional funds to support our operating expenses and capital requirements or for other purposes, such as acquisitions, and may seek to raise such additional funds through public or private equity or debt financings or collaborative agreements or from other sources. However, the COVID-19 pandemic continues to rapidly evolve and has already resulted in a significant disruption of global financial markets. If the disruption persists and deepens, we could experience an inability to access additional capital, which could in the future negatively affect our capacity to support our operating expenses and capital requirements or to make investments for other purposes, such as acquisitions. In addition, to preserve the tax-free treatment of our separation from NETGEAR, we have agreed in the tax matters agreement with NETGEAR to certain restrictions on our business, which generally will be effective during the two-year period following the special stock dividend (the "Distribution") by NETGEAR to NETGEAR stockholders of the 62,500,000 shares of Arlo common stock owned by NETGEAR that occurred on December 31, 2018, that could limit our ability to pursue certain transactions including equity issuances.

We have no commitments to obtain such additional financing and cannot assure you that additional financing will be available at all or, if available, that such financing would be obtainable on terms favorable to us and would not be dilutive. Our future liquidity and cash requirements will depend on numerous factors, including the introduction of new products, potential acquisitions of related businesses or technology.

The following table presents our cash flows for the periods presented:

	Nine Months Ended	
	September 27, 2020	September 29, 2019
	(In thousands)	
Net cash used in operating activities	\$ (59,317)	\$ (42,715)
Net cash used in investing activities	(2,155)	5,209
Net cash used in financing activities	(1,581)	82
Net cash decrease	<u>\$ (63,053)</u>	<u>\$ (37,424)</u>

Operating activities

Net cash used in operating activities increased by \$16.6 million for the nine months ended September 27, 2020 compared to the prior year period. This increase comprised \$35.8 million improvement in net cash used in operating activities excluding changes in working capital, primarily due to a reduction in net loss, offset by an increase in cash used in working capital of \$52.4 million, mainly as a result of a reduction in inventory in 2019 which has not been repeated in 2020.

Our days sales outstanding (“DSO”) decreased to 47 days as of September 27, 2020 compared to 97 days as of December 31, 2019, primarily as a result of customer mix, an increase in service revenue and growth in Arlo online store sales, all of which have shorter payment terms. Typically, our DSO in the fourth quarter is higher due to seasonal payment terms provided to our larger customers, while service revenue is typically a lower percentage of our revenue in the fourth quarter. Inventory increased marginally to \$69.0 million as of September 27, 2020 from \$68.6 million as of December 31, 2019, primarily due to higher inventory purchases, partially offset by lower on-hand inventory balance. Our ending inventory turns were 4.6x in the three months ended September 27, 2020 down from 5.9x turns in the three months ended December 31, 2019, primarily as a result of the normal seasonal reduction in our business, accentuated by the impact of COVID-19. Our accounts payable decreased to \$74.7 million as of September 27, 2020 from \$111.7 million as of December 31, 2019, primarily as a result of payments to suppliers for the purchases made in the fourth quarter of 2019 and the normal seasonality of our business.

Investing activities

Net cash used in investing activities increased by \$7.4 million for the nine months ended September 27, 2020 compared to the prior year period, primarily due to higher short-term investments of \$10.3 million, partially offset by less purchases of property and equipment of \$3.0 million due to the completion of leasehold improvements in 2019 at our San Jose headquarters.

Financing activities

Net cash used in financing activities of \$1.6 million and \$0.1 million in the nine months ended September 27, 2020 and September 29, 2019, respectively, represented withholding tax from restricted stock unit releases, offset by proceeds from ESPP contributions.

Contractual Obligations

Our principal commitments consist of obligations under operating leases for office space, equipment, data center facilities and distribution center facilities, as well as non-cancellable purchase commitments. Refer to Note 10.

Commitments and Contingencies, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q for a complete discussion of our contractual obligations.

Off-Balance Sheet Arrangements

As of September 27, 2020, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Critical Accounting Policies and Estimates

For a complete description of what we believe to be the critical accounting policies and estimates used in the preparation of our Unaudited Condensed Consolidated Financial Statements, refer to our Annual Report on Form 10-K for the year ended December 31, 2019. There have been no material changes to our critical accounting policies and estimates during the nine months ended September 27, 2020, other than as discussed in Note 2, *Significant Accounting Policies and Recent Accounting Pronouncements*, in the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q,

Recent Accounting Pronouncements

For a complete description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on financial condition and results of operations, refer to Note 2, *Summary of Significant Accounting Policies and Recent Accounting Pronouncements*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

During the nine months ended September 27, 2020, there were no material changes to our market risk disclosures as set forth in Part II Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2019.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, have evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures were, in design and operation, effective at the reasonable assurance level. A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within an organization have been detected.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended September 27, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We have not experienced any significant impact to our internal controls over financial reporting despite the fact that most of our employees are working remotely due to the COVID-19 pandemic. The design of our processes and controls allow for remote execution with accessibility to secure data. We are continually monitoring and assessing the COVID-19 situation to minimize the impact, if any, on the design and operating effectiveness on our internal controls.

PART II: OTHER INFORMATION

Item 1. *Legal Proceedings*

The information set forth under the heading “Litigation and Other Legal Matters” in Note 10, *Commitments and Contingencies*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, is incorporated herein by reference. For additional discussion of certain risks associated with legal proceedings, see the section entitled “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Item 1A. *Risk Factors*

Investing in our common stock involves substantial risk. You should consider carefully the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including our financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q, before deciding whether to invest in shares of our common stock. You should consider all of the factors described as well as the other information in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2020, as amended (the “Annual Report”), including our financial statements and the related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” when evaluating our business. The risk factors set forth below that are marked with an asterisk () contain changes to the similarly titled risk factors included in the Annual Report. We describe below what we believe are currently the material risks and uncertainties we face, but they are not the only risks and uncertainties we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that adversely affect our business. If any of the following risks actually occur, our business, financial condition, results of operations, and future prospects could be materially and adversely affected. In that event, the market price of our common stock could decline and you could lose part or all of your investment.*

Risks Related to Our Business

****The effects of health epidemics, including the recent COVID-19 pandemic, could have an adverse impact on our business, operations and the markets and communities in which we, our partners and customers operate.***

Our business and operations could be adversely affected by health epidemics, including the recent COVID-19 pandemic, impacting the markets and communities in which we, our partners and our customers operate. On March 11, 2020, the World Health Organization announced that COVID-19, a respiratory illness, caused by a novel coronavirus is a pandemic. The President of the United States has declared the COVID-19 pandemic a national emergency. In response to the COVID-19 pandemic, many state, local and foreign governments have put in place, and others in the future may put in place, quarantines, executive orders, shelter-in-place orders and similar government orders and restrictions in order to control the spread of the disease. Such orders or restrictions, or the perception that such orders or restrictions could occur, have resulted in business closures, work stoppages, slowdowns and delays, work-from-home policies, travel restrictions and cancellation of events, among other effects that could negatively impact productivity and disrupt our operations and those of our partners and our customers. For example, we have implemented a work-from-home policy for the vast majority of employees, and we may take further actions that alter our operations as may be required by federal, state or local authorities, or which we determine are in the best interests of our employees, customers, partners and stockholders. The effects of pandemic adversely affected our product shipments and financial results for the second quarter ended June 28, 2020.

In addition, while the potential impact and duration of the COVID-19 pandemic on the global economy and our business in particular may be difficult to assess or predict, the pandemic has resulted in, and may continue to result in significant disruption of global financial markets, reducing our ability to access capital, which could in the future negatively affect our liquidity. The COVID-19 pandemic also could reduce demand for our products and services as our largest channel partners focus on selling essential goods, temporarily close stores or experience decreases in foot traffic. In addition, a recession or market correction resulting from the spread of COVID-19 could further decrease technology

spending, adversely affecting demand for our products and services, our business and the value of our common stock. As of September 27, 2020, our retail channel inventory in Americas declined to 8.5 weeks compared to 13.5 weeks at September 29, 2019 due to disruption to our sales channel, contributing to a decline in net revenue in Americas by 11.3% and 9.0%, compared to the three and nine months ended September 29, 2019, respectively.

The COVID-19 pandemic may adversely affect the ability of our third-party manufacturers and other suppliers to fulfill their obligations to us. We rely on these manufacturers to procure components and, in some cases, subcontract engineering work. We also rely on other suppliers such as cloud infrastructure services providers, distribution centers and logistics and transportation services providers. If our manufacturers and other suppliers are unable to fulfill their obligations to us, we could face products shortages, delay in new product introductions, services to our customers could be interrupted, and our products distribution could be delayed and thus adversely affecting our revenue. For the three and nine months ended September 27, 2020, our freight-in expense increased by 41% and 85%, compared to the prior year periods.

The global pandemic of COVID-19 continues to rapidly evolve, and we will continue to monitor the COVID-19 situation closely. The ultimate impact of the COVID-19 pandemic or a similar health epidemic is highly uncertain and subject to change. We do not yet know the full extent of potential delays or impacts on our business, operations or the global economy as a whole.

We expect our results of operations to fluctuate on a quarterly and annual basis, which could cause our stock price to fluctuate or decline.

Our results of operations 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 results 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, but are not limited to:

- changes in the pricing policies of, or the introduction of new products by, us or our competitors;
- delays in the introduction of new products by us or market acceptance of these products;
- health epidemics and other outbreaks, including the COVID-19 pandemic, which could significantly disrupt our operations;
- introductions of new technologies and changes in consumer preferences that result in either unanticipated or unexpectedly rapid product category shifts;
- competition with greater resources may cause us to lower prices and in turn could result in reduced margins and loss of market share;
- epidemic or widespread product failure, or unanticipated safety issues, in one or more of our products;
- slow or negative growth in the connected lifestyle, home electronics, and related technology markets;
- seasonal shifts in end-market demand for our products;
- unanticipated decreases or delays in purchases of our products by our significant retailers, distributors, and other channel partners;
- component supply constraints from our vendors;

- unanticipated increases in costs, including air freight, associated with shipping and delivery of our products;
- the inability to maintain stable operations by our suppliers and other parties with whom we have commercial relationships;
- discovery of security vulnerabilities in our products, services or systems, leading to negative publicity, decreased demand, or potential liability;
- foreign currency exchange rate fluctuations in the jurisdictions where we transact sales and expenditures in local currency;
- excess levels of inventory and low turns;
- 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;
- delay or failure of our retailers, distributors, and other channel partners to purchase at their historic volumes or at the volumes that they or we forecast;
- changes in tax rates or adverse changes in tax laws that expose us to additional income tax liabilities;
- changes in U.S. and international tax policy, including changes that adversely affect customs, tax or duty rates (such as the tariffs on products imported from China enacted by the Trump administration), as well as income tax legislation and regulations that affect the countries where we conduct business;
- operational disruptions, such as transportation delays or failure of our order processing system, particularly if they occur at the end of a fiscal quarter;
- disruptions or delays related to our financial and enterprise resource planning systems;
- our inability to accurately forecast product demand, resulting in increased inventory exposure;
- allowance for doubtful accounts exposure with our existing retailers, distributors and other channel partners and new retailers, distributors and other channel partners, particularly as we expand into new international markets;
- geopolitical disruption, including sudden changes in immigration policies, leading to disruption in our workforce or delay or even stoppage of our operations in manufacturing, transportation, technical support, and research and development;
- terms of our contracts with channel partners or suppliers that cause us to incur additional expenses or assume additional liabilities;
- an increase in price protection claims, redemptions of marketing rebates, product warranty and stock rotation returns or allowance for doubtful accounts;
- litigation involving alleged patent infringement;

- failure to effectively manage our third-party customer support partners, which may result in customer complaints and/or harm to the Arlo brand;
- our inability to monitor and ensure compliance with our code of ethics, our anti-corruption compliance program, and domestic and international anti-corruption laws and regulations, whether in relation to our employees or with our suppliers or retailers, distributors, or other channel partners;
- labor unrest at facilities managed by our third-party manufacturers;
- workplace or human rights violations in certain countries in which our third-party manufacturers or suppliers operate, which may affect the Arlo brand and negatively affect our products' acceptance by consumers;
- unanticipated shifts or declines in profit by geographical region that would adversely impact our tax rate;
- failure to implement and maintain the appropriate internal controls over financial reporting, which may result in restatements of our financial statements; and
- any changes in accounting rules.

As a result, period-to-period comparisons of our results of operations may not be meaningful, and you should not rely on them as an indication of our future performance.

If we fail to continue to introduce or acquire new products or services that achieve broad market acceptance on a timely basis, or if our products or services are not adopted as expected, we will not be able to compete effectively and we will be unable to increase or maintain revenue and gross margin.

We operate in a highly competitive, quickly changing environment, and our future success depends on our ability to develop or acquire and introduce new products and services that achieve broad market acceptance. Our future success will depend in large part upon our ability to identify demand trends in the connected lifestyle market and quickly develop or acquire, and design, manufacture and sell, products and services that satisfy these demands in a cost-effective manner.

In order to differentiate our products and services from our competitors' products, we must continue to increase our focus and capital investment in research and development, including software development. We have committed a substantial amount of resources to the manufacture, development and sale of our Arlo Smart services and our wire-free smart Wi-Fi cameras, advanced baby monitors, and smart lights, and to introducing additional and improved models in these lines. In addition, we plan to continue to introduce new categories of smart connected devices to the Arlo platform in the near future. If our existing products and services do not continue, or if our new products or services fail, to achieve widespread market acceptance, if existing customers do not subscribe to our paid subscription services such as Arlo Smart, if those services do not achieve widespread market acceptance, or if we are unsuccessful in capitalizing on opportunities in the connected lifestyle market, as well as in the related market in the small business segment, our future growth may be slowed and our business, results of operations, and financial condition could be materially adversely affected. Successfully predicting demand trends is difficult, and it is very difficult to predict the effect that introducing a new product or service will have on existing product or service sales. It is possible that Arlo may not be as successful with its new products and services, and as a result our future growth may be slowed and our business, results of operations and financial condition could be materially adversely affected. Also, we may not be able to respond effectively to new product or service announcements by our competitors by quickly introducing competitive products and services.

In addition, we may acquire companies and technologies in the future and, consistent with our vision for Arlo, introduce new product and service lines in the connected lifestyle market. In these circumstances, we may not be able to successfully manage integration of the new product and service lines with our existing suite of products and services. If we

are unable to effectively and successfully further develop these new product and service lines, we may not be able to increase or maintain our sales, and our gross margin may be adversely affected.

We may experience delays and quality issues in releasing new products and services, which may result in lower quarterly revenue than expected. In addition, we may in the future experience product or service introductions that fall short of our projected rates of market adoption. Currently, reviews of our products and services are a significant factor in the success of our new product and service launches. If we are unable to generate a high number of positive reviews or quickly respond to negative reviews, including end-user reviews posted on various prominent online retailers, our ability to sell our products and services will be harmed. Any future delays in product and service development and introduction, or product and service introductions that do not meet broad market acceptance, or unsuccessful launches of new product and service lines 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 and services;
- adverse reactions in our sales channels, such as reduced shelf space, reduced online product visibility, or loss of sales channels; and
- increased levels of product returns.

Throughout the past few years, Arlo has significantly increased the rate of new product and service introductions, with the introduction of new lines of Arlo cameras, smart lights, and doorbell products, as well as the introduction of our Arlo Smart services. If we cannot sustain that pace of product and service introductions, either through rapid innovation or acquisition of new products and services or product and service lines, we may not be able to maintain or increase the market share of our products and services or expand further into the connected lifestyle market in accordance with our current plans. In addition, if we are unable to successfully introduce or acquire new products and services with higher gross margin, our revenue and overall gross margin would likely decline.

****We may need additional financing to meet our future long-term capital requirements and may be unable to raise sufficient capital on favorable terms or at all.***

We have recorded a net loss of \$17.5 million and \$86.0 million for the three and nine months ended September 27, 2020, respectively, and we have a history of losses and may continue to incur operating and net losses for the foreseeable future. As of September 27, 2020, our accumulated deficit was \$217.6 million.

As of September 27, 2020, our cash and cash equivalents and short-term investments totaled \$193.6 million. While we anticipate that our current cash, cash equivalents and cash to be generated from operations will be sufficient to meet our projected operating plans through at least the next 12 months, we may require additional funds, either through equity or debt financings or collaborative agreements or from other sources. We have no commitments to obtain such additional financing, and we may not be able to obtain any such additional financing on terms favorable to us, or at all. If adequate financing is not available, we may further delay, postpone or terminate product and service expansion and curtail certain selling, general and administrative operations. The inability to raise additional financing may have a material adverse effect on our future performance. In addition, the COVID-19 pandemic has already resulted in a significant disruption of global financial markets. If the disruption persists and deepens, we could experience an inability to access additional capital.

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 fiercely competitive market, and we expect competition to continue to be intense, including price competition. Our principal competitors include Amazon (Blink and Ring), Google (Nest), Swann, Night Owl, Wyze, Foxconn Corporation (Belkin), Samsung, D-Link, and Canary. Other competitors include numerous local vendors such as Netatmo, Logitech, Bosch, Instar, and Uniden. In addition, these local vendors may target markets outside of their local regions and may increasingly compete with us in other regions worldwide. Many of our existing and potential competitors have longer operating histories, greater brand 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. In addition, certain competitors may have different business models, such as integrated manufacturing capabilities, that may allow them to achieve cost savings and to compete on the basis of price. Other competitors may have fewer resources, but may be more nimble in developing new or disruptive technology or in entering new markets.

We anticipate that current and potential competitors will also intensify their efforts to penetrate our target markets. For example, price competition is intense in our industry in certain geographical regions and product categories. Many of our competitors price their products significantly below our product costs. Average sales prices have declined in the past and may again 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 retailers, distributors, and other channel partners, and end-user bases than we do.

In addition, many of these competitors leverage a broader product portfolio and offer lower pricing as part of a more comprehensive end-to-end solution. These companies could devote more capital resources to develop, manufacture, and market competing products than we could.

Amazon is both a competitor and a distribution channel for our products as well as a provider of services to support our cloud-based storage. If Amazon decided to end our distribution channel relationship or ceased providing cloud storage services to us, our sales and product performance could be harmed, which could seriously harm our business, financial condition, results of operations, and cash flows.

Our competitors may also acquire other companies in the market and leverage combined resources to gain market share. 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, financial condition, and results of operations.

If we lose the services of 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, engineering, sales, marketing, finance, and senior management personnel. The competition for qualified personnel with significant experience in the design, development, manufacturing, marketing, and sales in the markets in which we operate is intense, both where our U.S. operations are based, including Silicon Valley, and in global markets in which we operate. Our inability to attract qualified personnel, including hardware and software engineers and sales and marketing personnel, could delay the development and introduction of, and harm our ability to sell, our products and services. Decreases in our stock price may negatively affect our efforts to attract and retain qualified personnel. Changes to U.S. immigration policies that restrict our ability to attract and retain technical personnel may negatively affect our research and development efforts. We will continue to replace key personnel, from within or looking outside, wherever we find the best candidates.

We do not maintain any key person life insurance policies. Our business model requires extremely skilled and experienced senior management who are able to withstand the rigorous requirements and expectations of our business. Our success depends on senior management being able to execute at a very high level. The loss of any of our senior management or other key engineering, 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 our

business. If we suffer the loss of services of any key executive or key personnel, our business, results of operations, and financial condition could be materially adversely affected. In addition, we may not be able to have the proper personnel in place to effectively execute our long-term business strategy if key personnel retire, resign or are otherwise terminated.

****We recently entered into an asset purchase agreement (the “Asset Purchase Agreement”) and supply agreement (the “Supply Agreement”) with Verisure Sàrl (“Verisure”) that will give Verisure exclusive marketing and distribution rights for our products in Europe as well as the ability to sell our products through their direct channel globally. We cannot provide assurance that the arrangement with Verisure will be a successful collaboration.***

Verisure will have the exclusive right to market and distribute our products in Europe. Our results of operations may be negatively impacted if Verisure is not successful in selling our products in Europe. Even though the Supply Agreement provides for minimum purchase commitments, if Verisure fails to pay on a timely basis, or at all, including because of effects from COVID-19, or otherwise does not perform under the Supply Agreement our cash flow would be reduced. We are also exposed to increased credit risk if Verisure fails or becomes insolvent. We also cannot provide any assurance that we will successfully develop custom products as specified by Verisure under the Supply Agreement.

The Purchase Agreement and Supply Agreement with Verisure contains customary representations and warranties regarding, the Business and the Assets, indemnification provisions, termination rights, certain financial covenants and other customary provisions. Additionally, we have agreed not to engage in any business that competes with the Business for a period of three years. Our failure to comply with these provisions may have a material adverse effect on our future performance.

****We are subject to financial and operating covenants in our business financing agreement with Western Alliance Bank (the “Credit Agreement”) and any failure to comply with such covenants, or obtain waivers in the event of non-compliance, could limit our borrowing availability under the Credit Agreement, resulting in our being unable to borrow under the Credit Agreement and materially adversely impact our liquidity. In addition, our operations may not provide sufficient cash to meet the repayment obligations of debt incurred under the Credit Agreement.***

The Credit Agreement contains provisions that limit our future borrowing availability to the lesser of (x) \$40.0 million and (y) an amount equal to 60% of our eligible receivables and eligible accounts receivable, less such reserves as Western Alliance Bank may deem proper and necessary from time to time. The Credit Agreement also contains other customary covenants, including certain restrictions on maintaining a minimum cash balance, our ability to incur additional indebtedness, consolidate or merge, enter into acquisitions, pay any dividend or distribution on our capital stock, redeem, retire or purchase shares of our capital stock, make investments or pledge or transfer assets, in each case subject to limited exceptions.

There can be no assurance that we will be able to comply with the financial and other covenants in the Credit Agreement, and the effects of the COVID-19 pandemic may increase the risk of our inability to comply with such covenants. Our failure to comply with these covenants could cause us to be unable to borrow under the Credit Agreement and may constitute an event of default which, if not cured or waived, could result in the acceleration of the maturity of any indebtedness then outstanding under the Credit Agreement, which would require us to pay all amounts then outstanding. If we are unable to repay those amounts, the Lender could proceed against the collateral granted to them to secure that debt, which would seriously harm our business. Such an event could materially adversely affect our financial condition and liquidity. Additionally, such events of non-compliance could impact the terms of any additional borrowings and/or any credit renewal terms. Any failure to comply with such covenants may be a disclosable event and may be perceived negatively. Such perception could adversely affect the market price for our common stock and our ability to obtain financing in the future.

System security risks, data protection breaches and cyber-attacks could disrupt our products, services, internal operations, or information technology systems, and could lead to theft of our intellectual property, and any such

disruption could reduce our expected revenue, increase our expenses, damage our reputation, and cause our stock price to decline significantly.

Information security risks have significantly increased in recent years in part due to the proliferation of new technologies and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties, including foreign private parties and state actors. Our products and services may contain unknown security vulnerabilities. For example, the firmware, software, and open source software that we or our manufacturing partners have installed on our products may be susceptible to hacking or misuse. In addition, we offer a comprehensive online cloud management service paired with our end products, including our cameras, baby monitors, and smart lights and we recently launched our online store to sell our products directly to our customers. If malicious actors compromise this cloud service or our online store, or if customer confidential information is accessed without authorization, our business will be harmed. Operating an online cloud service and online store are a relatively new businesses for us, and we may not have the expertise to properly manage risks related to data security and systems security. We rely on third-party providers for a number of critical aspects of our cloud services and customer support, including web hosting services, billing, and payment processing, and consequently we do not maintain direct control over the security or stability of the associated systems. If we or our third-party providers are unable to successfully prevent breaches of security relating to our products, services, or user private information, including user videos and user personal identification information, or if these third-party systems fail for other reasons, our management could need to spend increasing amounts of time and effort in this area. As a result, we could incur substantial expenses, our brand and reputation could suffer and our business, results of operations, and financial condition could be materially adversely affected.

Maintaining the security of our computer information systems and communication systems is a critical issue for us and our customers. Malicious actors may develop and deploy malware that is designed to manipulate our systems, including our internal network, or those of our vendors or customers. Additionally, outside parties may attempt to fraudulently induce our employees to disclose sensitive information in order to gain access to our information technology systems, our data or our customers' data. We have established a crisis management plan and business continuity program. While we regularly test the plan and the program, there can be no assurance that the plan and program can withstand an actual or serious disruption in our business, including cyber-attack. While we have established service-level and geographic redundancy for our critical systems, our ability to utilize these redundant systems must be tested regularly, failing over to such systems always carries risk and we cannot be assured that such systems are fully functional. For example, much of our order fulfillment process is automated and the order information is stored on our servers. A significant business interruption could result in losses or damages and harm our business. If our computer systems and servers become unavailable at the end of a fiscal quarter, our ability to recognize revenue may be delayed until we are able to utilize back-up systems and continue to process and ship our orders. This could cause our stock price to decline significantly.

We devote considerable internal and external resources to network security, data encryption, and other security measures to protect our systems, customers, and users, but these security measures cannot provide absolute security. Potential breaches of our security measures and the accidental loss, inadvertent disclosure, or unapproved dissemination of proprietary information or sensitive or confidential data about us, our employees, or our customers or users, including the potential loss or disclosure of such information or data as a result of employee error or other employee actions, hacking, fraud, social engineering, or other forms of deception could expose us, our customers, or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation, or otherwise materially adversely affect our business, results of operations, and financial condition. In addition, the cost and operational consequences of implementing further data protection measures could be significant and theft of our intellectual property or proprietary business information could require substantial expenditures to remedy.

Our future success depends on our ability to increase sales of our paid subscription services.

Our future success is largely dependent on increasing sales of our paid subscription services. Even if we are successful in selling our smart connected devices and accessories, if we are unable to maintain or increase sales of Arlo Smart services, our revenue and overall gross margin would likely decline.

****Interruptions with the cloud-based systems that we use in our operations provided by an affiliate of Amazon.com, Inc. ("Amazon"), which is also one of our primary competitors, may materially adversely affect our business, results of operations, and financial condition.***

We host our platform using Amazon Web Services ("AWS") data centers, a provider of cloud infrastructure services, and may in the future use other third-party cloud-based systems in our operations. All of our solutions currently reside on systems leased and operated by us in these locations. Accordingly, our operations depend on protecting the virtual cloud infrastructure hosted in AWS by maintaining its configuration, architecture, features, and interconnection specifications, as well as the information stored in these virtual data centers and which third-party internet service providers transmit. Although we have disaster recovery plans that utilize multiple AWS locations, any incident affecting their infrastructure that may be caused by human error, fire, flood, severe storm, earthquake, or other natural disasters, cyber-attacks, terrorist or other attacks, and other similar events beyond our control could negatively affect our platform. A prolonged AWS service disruption affecting our platform for any of the foregoing reasons would negatively impact our ability to serve our end-users and could damage our reputation with current and potential end-users, expose us to liability, cause us to lose customers, or otherwise harm our business. We may also incur significant costs for using alternative equipment or taking other actions in preparation for, or in reaction to, events that damage the AWS services we use. Further, if we were to make updates to our platforms that were not compatible with the configuration, architecture, features, and interconnection specifications of the third-party platform, our service could be disrupted.

Amazon produces the Amazon Cloud Cam, which competes with our security camera products, and recently acquired two of our competitors, Blink and Ring. Amazon may choose to hamper our competitive efforts, using provision of AWS services as leverage. In the event that there is a lapse of service, elimination of AWS services or features that we use, interruption of internet service provider connectivity, or damage to such facilities, we could experience interruptions in access to our platform as well as significant delays and additional expense in arranging or creating new facilities and services and/or re-architecting our solutions for deployment on a different cloud infrastructure service provider, which could materially adversely affect our business, results of operations, and financial condition.

Our current and future products may experience quality problems, including defects or errors, from time to time that can result in adverse publicity, product recalls, litigation, regulatory proceedings, and warranty claims resulting in significant direct or indirect costs, decreased revenue, and operating margin, and harm to our brand.

We sell complex products that could contain design and manufacturing defects in their materials, hardware, and firmware. These defects could include defective materials or components that can unexpectedly interfere with the products' intended operations or cause injuries to users or property damage. Although we extensively and rigorously test new and enhanced products and services before their release, we cannot assure we will be able to detect, prevent, or fix all defects. Failure to detect, prevent, or fix defects, or an increase in defects, could result in a variety of consequences, including a greater number of product returns than expected from users and retailers, increases in warranty costs, regulatory proceedings, product recalls, and litigation, each of which could materially adversely affect our business, results of operations, and financial condition. We generally provide a one-year hardware warranty on all of our products. The occurrence of real or perceived quality problems or material defects in our current and future products could expose us to warranty claims in excess of our current reserves. If we experience greater returns from retailers or users, or greater warranty claims, in excess of our reserves, our business, financial condition, and results of operations could be harmed. In addition, any negative publicity or lawsuits filed against us related to the perceived quality and safety of our products could also adversely affect our brand, decrease demand for our products and services, and materially adversely affect our business, results of operations, and financial condition.

In addition, epidemic failure clauses are found in certain of our customer contracts. If invoked, these clauses may entitle the customer to return for replacement or obtain credits for products and inventory, as well as assess liquidated damage penalties and terminate an existing contract and cancel future or then-current purchase orders. In such instances, we may also be obligated to cover significant costs incurred by the customer associated with the consequences of such epidemic failure, including freight and transportation required for product replacement and out-of-pocket costs for truck

rolls to end-user sites to collect the defective products. Costs or payments we make in connection with an epidemic failure could materially adversely affect our business, results of operations, and financial condition.

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, defects in, or misuse of, certain of our products could cause safety concerns, including the risk of property damage or personal injury. If any of these events occurred, our reputation and brand could be damaged, and we could face product liability or other claims regarding our products, resulting in unexpected expenses and adversely impacting 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 end-user data, third-party data stored by our users, and other information, including intellectual property. If that happens, affected end-users or others may file actions against us alleging product liability, tort, or breach of warranty claims.

****We rely on a limited number of traditional and online retailers and wholesale distributors for a substantial portion of our sales, and our revenue could decline if they refuse to pay our requested prices or reduce their level of purchases or if there is significant consolidation in our sales channels, which results in fewer sales channels for our products.***

We sell a substantial portion of our products through traditional and online retailers, including Best Buy Co., Inc. ("Best Buy"), and Costco Wholesale Corporation ("Costco"), and Amazon and their respective affiliates. For the three and nine months ended September 27, 2020, we derived 12.3% and 14.2% of our revenue from Amazon and its affiliates, 23.6% and 20.5% of our revenue from Costco and its affiliates, 25.4% and 19.2% of our revenue from Verisure Ireland DAC and its affiliates, and 9.9% and 11.0% of our revenue from Best Buy and its affiliates, respectively. In addition, we sell to wholesale distributors, including Also Holdings AG, Ingram Micro, Inc., D&H Distributing Company, Exertis (UK) Ltd., and Synnex Corporation. We expect that a significant portion of our revenue will continue to come from sales to a small number of such retailers, distributors, and other channel partners. In addition, because our accounts receivable are often concentrated within a small group of retailers, distributors, and other channel partners, the failure of any of them to pay on a timely basis, or at all, would reduce our cash flow. If Best Buy or other retailers closes any of its retail stores due to COVID-19 pandemic, our revenue could be adversely impacted. We are also exposed to increased credit risk if any one of these limited numbers of retailer and distributor channel partners fails or becomes insolvent. We generally have no minimum purchase commitments or long-term contracts with any of these retailers, distributors and other channel partners. These purchasers could decide at any time to discontinue, decrease, or delay their purchases of our products. If our retailers, distributors, and other channel partners increase the size of their product orders without sufficient lead-time for us to process the order, our ability to fulfill product orders would be compromised. These channel partners have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. Accordingly, the prices that they pay for our products are subject to negotiation and could change at any time. We have historically benefited from NETGEAR's strong relationships with these retailers, distributors, and other channel partners, and we may not be able to maintain these relationships following our separation from NETGEAR. Our ability to maintain strong relationships with these channel partners is essential to our future performance. If any of our major channel partners reduce their level of purchases or refuse to pay the prices that we set for our products, our revenue and results of operations could be harmed. The traditional retailers that purchase from us have faced increased and significant competition from online retailers. If our key traditional retailers continue to reduce their level of purchases from us, our business, results of operations, and financial condition could be harmed.

Additionally, concentration and consolidation among our channel partner base may allow certain retailers and distributors to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, if, as a result of increased leverage, channel partner pressures require us to reduce our pricing such that our gross margin is diminished, we could decide not to sell our products to a particular channel partner, which could result in a decrease in our revenue. Consolidation among our channel partner base may also lead to reduced demand for our products, elimination of sales opportunities, replacement of our products with those of our competitors, and cancellations of orders, each of which could materially adversely affect our business, results of operations, and financial

condition. If consolidation among the retailers, distributors, or other channel partners who purchase our products becomes more prevalent, our business, results of operations, and financial condition could be materially adversely affected.

In particular, the retail and connected home markets in some countries, including the United States, are dominated by a few large retailers with many stores. These retailers have in the past increased their market share and may continue to do so in the future by expanding through acquisitions and construction of additional stores. These situations concentrate our credit risk with a relatively small number of retailers, and, if any of these retailers were to experience a shortage of liquidity, it could increase the risk that their outstanding payables to us may not be paid. In addition, increasing market share concentration among one or a few retailers in a particular country or region increases the risk that if any one of them substantially reduces its purchases of our devices, we may be unable to find a sufficient number of other retail outlets for our products to sustain the same level of sales. Any reduction in sales by our retailers could materially adversely affect our business, results of operations, and financial condition.

****We depend on large, recurring purchases from certain significant retailers, distributors, and other channel partners, and a loss, cancellation, or delay in purchases by these channel partners could negatively affect our revenue.***

The loss of recurring orders from any of our more significant retailers, distributors, and other channel partners could cause our revenue and profitability to suffer. Our ability to attract new retailers, distributors, and other channel partners 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 retailers, distributors, and other channel partners, or a change in the mix of direct and indirect sales, could adversely affect our revenue and gross margin.

Although our financial performance may depend on large, recurring orders from certain retailers, distributors, and other channel partners, we do not generally have binding commitments from them. For example:

- our channel partner agreements generally do not require minimum purchases;
- our retailers, distributors, and other channel partners can stop purchasing and stop marketing our products at any time; and
- our channel partner agreements generally are not exclusive.

Further, our revenue may be impacted by significant one-time purchases that are not contemplated to be repeatable. While such purchases are reflected in our financial statements, we do not rely on and do not forecast for continued significant one-time purchases. As a result, lack of repeatable one-time purchases will adversely affect our revenue. Additionally, we may from time to time grant our retailers, distributors, and other channel partners the exceptional right to return certain products, based on the best interests of our mutual businesses, and such returns, if material, could adversely affect our revenue and gross margin.

Because our expenses are based on our revenue forecasts, a substantial reduction or delay in sales of our products to, or unexpected returns from, channel partners, or the loss of any significant channel partners, could materially adversely affect our business, results of operations, and financial condition. Although our largest channel partners may vary from period to period, we anticipate that our results of operations for any given period will continue to depend on large orders from a small number of channel partners.

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

Our products typically experience price erosion, a fairly rapid reduction in the average unit selling prices over their 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 partner 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, and 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 margin in order to maintain our overall gross margin. If we are unable to manage the cost of older products or successfully introduce new products with higher gross margin, our revenue and overall gross margin would likely decline.

The reputation of our services may be damaged, and we may face significant direct or indirect costs, decreased revenue, and operating margins if our services contain significant defects or fail to perform as intended.

Our services, including our intelligent cloud and App platform and our Arlo Smart services, are complex, and may not always perform as intended due to outages of our systems or defects affecting our services. Systems outages could be disruptive to our business and damage the reputation of our services and result in potential loss of revenue.

Significant defects affecting our services may be found following the introduction of new software or enhancements to existing software or in software implementations in varied information technology environments. Internal quality assurance testing and end-user testing may reveal service performance issues or desirable feature enhancements that could lead us to reallocate service development resources or postpone the release of new versions of our software. The reallocation of resources or any postponement could cause delays in the development and release of future enhancements to our currently available software, damage the reputation of our services in the marketplace, and result in potential loss of revenue. Although we attempt to resolve all errors that we believe would be considered serious by our partners and customers, the software powering our services is not error-free. Undetected errors or performance problems may be discovered in the future, and known errors that we consider minor may be considered serious by our channel partners and end-users.

System disruptions and defects in our services could result in lost revenue, delays in customer deployment, or legal claims and could be detrimental to our reputation.

Because we store, process, and use data, some of which contain personal information, we are subject to complex and evolving federal, state, and foreign laws and regulations regarding privacy, data protection, and other matters, which are subject to change.

We are subject to a variety of laws and regulations in the United States and other countries that involve matters central to our business, including with respect to user privacy, rights of publicity, data protection, content, protection of minors, and consumer protection. These laws can be particularly restrictive in countries outside the United States. Both in the United States and abroad, these laws and regulations constantly evolve and remain subject to significant change. In addition, the application and interpretation of these laws and regulations are often uncertain, particularly in the new and rapidly evolving industry in which we operate. Because we store, process, and use data, some of which contain personal information, we are subject to complex and evolving federal, state, and foreign laws and regulations regarding privacy, data protection, and other matters. Many of these laws and regulations are subject to change and uncertain interpretation and could result in investigations, claims, changes to our business practices, increased cost of operations, and declines in user growth, retention, or engagement, any of which could materially adversely affect our business, results of operations, and financial condition.

Several proposals are pending before federal, state and foreign legislative and regulatory bodies that could significantly affect our business. For example, a revision to the 1995 European Union Data Protection Directive is currently

being considered by European legislative bodies that may include more stringent operational requirements for data processors and significant penalties for non-compliance. In addition, the EU General Data Protection Regulation 2016/679 (“GDPR”), which came into effect on May 25, 2018, establishes new requirements applicable to the processing of personal data (*i.e.*, data which identifies an individual or from which an individual is identifiable), affords new data protection rights to individuals (*e.g.*, the right to erasure of personal data) and imposes penalties for serious data breaches. Individuals also have a right to compensation under GDPR for financial or non-financial losses. California also recently enacted legislation that has been dubbed the first “GDPR-like” law in the U.S. Known as the California Consumer Privacy Act (“CCPA”), it creates new individual privacy rights for consumers (as that word is broadly defined in the law) and places increased privacy and security obligations on entities handling personal data of consumers or households. The CCPA, which went into effect on January 1, 2020, requires covered companies to provide new disclosures to California consumers, and provides such consumers new ways to opt-out of certain sales of personal information. The CCPA provides for civil penalties for violations, as well as a private right of action for data breaches that is expected to increase data breach litigation. The CCPA may increase our compliance costs and potential liability. Some observers have noted that the CCPA could mark the beginning of a trend toward more stringent privacy legislation in the U.S., which could increase our potential liability and adversely affect our business. GDPR and CCPA will impose additional responsibility and liability in relation to our processing of personal data. GDPR and CCPA may require us to change our policies and procedures and, if we are not compliant, could materially adversely affect our business, results of operations, and financial condition.

**** Global economic conditions could 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 markets, and changes in the overall demand for connected lifestyle products. Our products and services may be considered discretionary items for our consumer and small business end-users. A severe and/or prolonged economic downturn, including as a result of the COVID-19 pandemic, could adversely affect our customers’ financial condition and the levels of business activity of our customers. Weakness in, and uncertainty about, global economic conditions may cause businesses to postpone spending in response 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 our products.

In the recent past, various regions worldwide have experienced slow economic growth. In addition, current economic challenges in China, including any global economic ramifications of these challenges, may continue to put negative pressure on global economic conditions. If conditions in the global economy, including Europe, China, Australia and the United States, or other key vertical or geographic markets deteriorate, such conditions could materially adversely affect our business, results of operations, and financial condition. 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, results of operations, and financial condition. In addition, the economic problems affecting the financial markets and the uncertainty in global economic conditions resulted in a number of adverse effects, including a low level of liquidity in many financial markets, extreme volatility in credit, equity, currency, and fixed income markets, instability in the stock market, and high unemployment.

For example, the challenges faced by the European Union to stabilize some of its member economies, such as Greece, Portugal, Spain, Hungary, and Italy, have had international implications, affecting the stability of global financial markets and hindering economies worldwide. Many member nations in the European Union have been addressing the issues with controversial austerity measures. In addition, the potential consequences of the “Brexit” process in the United Kingdom have led to significant uncertainty in the region. Should the European Union monetary policy measures be insufficient to restore confidence and stability to the financial markets, or should the United Kingdom’s “Brexit” decision lead to additional economic or political instability, the global economy, including the U.S. and European Union economies where we have a significant presence, could be hindered, which could have a material adverse effect on us. There could also be a number of other follow-on effects from these economic developments 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.

In addition, availability of our products from third-party manufacturers and our ability to distribute our products into non-U.S. jurisdictions may be impacted by factors such as an increase in duties, tariffs, or other restrictions on trade; raw material shortages, work stoppages, strikes and political unrest; economic crises and international disputes or conflicts; changes in leadership and the political climate in countries from which we import products; and failure of the United States to maintain normal trade relations with China and other countries.

A portion of our global and U.S. sales are comprised of goods assembled and manufactured in our facilities in Taiwan and the People's Republic of China, and components for a number of our goods are sourced from suppliers in the People's Republic of China. When tariffs, duties, or other restrictions are placed on goods imported into the United States from China or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed.

On September 17, 2018, President Trump announced the imposition of an additional 10% ad valorem duty on approximately \$200 billion worth of Chinese imports, known as List 3, pursuant to Section 301 of the Trade Act of 1974. The Office of the U.S. Trade Representative concurrently published the final list of products that are subject to the additional duty, effective September 24, 2018. On May 10, 2019, the President increased the additional duty to 25% ad valorem, and has since proposed a further increase of this rate to 30%, though the increase is not currently scheduled to take effect. In addition, on August 20, 2019, the President announced an additional 15% import duty on other Chinese imports, known as List 4, with the additional duties on certain items (List 4A) effective September 1, 2019, and the remainder (List 4B) effective December 15, 2019. While the additional duty on List 4A has gone into effect, the implementation of the additional duty on List 4B has been suspended indefinitely. Further, as of February 14, 2020, the additional duty rate on items listed on List 4A is reduced from 15% to 7.5%. We are actively addressing the risks related to these additional and potential ad valorem duties, which have affected, or have the potential to affect, at least some of our imports from China. Although we have already taken some steps to mitigate these risks, including by moving a significant portion of our manufacturing and assembly to Vietnam and other areas in the Asia Pacific region outside of China, if these duties are imposed, the cost of our products may increase. These duties may also make our products more expensive for consumers, which may reduce consumer demand. We may need to offset the financial impact by, among other things, moving even more of our product manufacturing to other locations, modifying other business practices or raising prices. If we are not successful in offsetting the impact of any such duties, our revenue, gross margins, and operating results may be materially adversely affected.

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

There has been significant volatility in the market price and trading volume of securities of technology and other companies, including recently in connection with the ongoing COVID-19 pandemic, 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 the market price of our common stock include:

- actual or anticipated fluctuations in our results of operations or our competitors' operating results;
- actual or anticipated changes in the growth rate of the connected lifestyle market, our growth rate or our competitors' growth rates;
- delays in the introduction of new products by us or market acceptance of these products;
- conditions in the financial markets in general or changes in general economic conditions, including due to the COVID-19 pandemic;
- changes in governmental regulation, including taxation and tariff policies;

- interest rate or currency exchange rate fluctuations;
- our ability to forecast or report accurate financial results; and
- changes in stock market analyst recommendations regarding our common stock, other comparable companies, or our industry generally.

We obtain several key components from limited or sole sources, and if these sources fail to satisfy our supply requirements or we are unable to properly manage our supply requirements with our third-party manufacturers, 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 components used in our products are specifically designed for use in our products, some of which are obtained from sole source suppliers. These components include lens, lens-sensors, and passive infrared (“PIR”) sensors that have been customized for the Arlo application, as well as custom-made batteries that provide power conservation and safety features. In addition, the components used in our end products have been optimized to extend battery life. Our third-party manufacturers generally purchase these components on our behalf, 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 worldwide demand for the components increases significantly, the availability of these components could be limited. Further, our suppliers may experience financial or other difficulties as a result of uncertain and weak worldwide economic conditions. Other factors that may affect our suppliers’ ability or willingness to supply components to us include internal management or reorganizational issues, such as roll-out of new equipment which may delay or disrupt supply of previously forecasted components, or industry consolidation and divestitures, which may result in changed business and product priorities among certain suppliers. 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.

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, 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.

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 or our cost of obtaining these components may increase. For example, in December 2018 we announced a delay in the expected timing of shipment of our Ultra product due to a battery-related issue from one of our suppliers. Component shortages and delays affect our ability to meet scheduled product deliveries, damage our brand and reputation in the market, and cause us to lose sales and market share. For example, component shortages and disruptions in supply in the past have limited our ability to supply all the worldwide demand for our products, and our revenue was affected. At times, we have elected to use more expensive transportation methods, such as air freight, to make up for manufacturing delays caused by component shortages, which reduces our margins. In addition, at times sole suppliers of highly specialized components have provided components that were either defective or did not meet the criteria required by our retailers, distributors, or other channel partners, resulting in delays, lost revenue opportunities, and potentially substantial write-offs.

****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, including due to the COVID-19 pandemic, 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 third-party original design manufacturers (“ODMs”). In most cases, we rely on these manufacturers to procure components and, in some cases, subcontract engineering work. We currently outsource manufacturing to Foxconn Cloud Network Technology Singapore Pte. Ltd., Pegatron Corporation, and Sky Light Industrial Ltd. We do not have any long-term contracts with any of these third-party manufacturers, although we have executed product supply agreements with these manufacturers, which typically provide indemnification for intellectual property infringement, epidemic failure clauses, agreed-upon price concessions, and certain product quality requirements. Some of these third-party manufacturers produce products for our competitors. In addition, one of our principal manufacturers, Foxconn closed its acquisition of Belkin International in September 2018, which includes the WeMo brand of home automation products, which may compete directly with us. Due to changing economic conditions, including due to the COVID-19 pandemic, 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. Ensuring that a contract manufacturer is qualified to manufacture our products to our standards is time consuming. In addition, there is no assurance that a contract manufacturer can scale its production of our products at the volumes and in the quality that we require. If a contract manufacturer is unable to do these things, we may have to move production for the products to a new or existing third-party manufacturer, which would take significant effort and our business, results of operations, and financial condition could be materially adversely affected. In addition, as we contemplate moving manufacturing into different jurisdictions, we may be subject to additional significant challenges in ensuring that quality, processes, and costs, among other issues, are consistent with our expectations. For example, while we expect our manufacturers to be responsible for penalties assessed on us because of excessive failures of the products, there is no assurance that we will be able to collect such reimbursements from these manufacturers, which causes us to take on additional risk for potential failures of our products.

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 and reliability of finished products;
- inability to control delivery schedules;
- potential liability for expenses incurred by third-party manufacturers in reliance on our forecasts that later prove to be inaccurate;
- potential lack of adequate capacity to manufacture all or a part of the products we require; and
- potential labor unrest affecting the ability of the third-party manufacturers to produce our products.

All of our products must satisfy safety and regulatory standards and some of our products must also receive government certifications. Our third-party manufacturers are primarily responsible for conducting the tests that support our applications for most regulatory approvals for our products. If our third-party manufacturers fail to timely and accurately conduct these tests, we would be unable to obtain the necessary domestic or foreign regulatory approvals or certificates to sell our products in certain jurisdictions. As a result, 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.

Specifically, substantially all of our manufacturing and assembly occurs in the Asia Pacific region, primarily in Vietnam, and any disruptions due to natural disasters, health epidemics, and political, social, and economic instability in

the region would affect the ability of our third-party manufacturers to manufacture our products. In particular, in the event the labor market in Vietnam becomes saturated, our third-party manufacturers in Vietnam may increase our costs of production. If these costs increase, it may affect our margins and ability to lower prices for our products to stay competitive. Labor unrest may also affect our third-party manufacturers, as workers may strike and cause production delays. If our third-party manufacturers fail to maintain good relations with their employees or contractors, and production and manufacturing of our products are affected, then we may be subject to shortages of products and the quality of products delivered may be affected. Further, if our manufacturers or warehousing facilities are disrupted or destroyed, we could have no other readily available alternatives for manufacturing and assembling our products, and our business, results of operations, and financial condition could be materially adversely affected.

In the future, we may work with more third-party manufacturers on a contract manufacturing basis, which could result in our exposure to additional risks not inherent in a typical ODM arrangement. Such risks may include our inability to properly source and qualify components for the products, lack of software expertise resulting in increased software defects, and lack of resources to properly monitor the manufacturing process. In our typical ODM arrangement, our ODMs are generally responsible for sourcing the components of the products and warranting that the products will work according to a product's specification, including any software specifications. In a contract manufacturing arrangement, we would take on much more, if not all, of the responsibility around these areas. If we are unable to properly manage these risks, our products may be more susceptible to defects, and our business, results of operations, and financial condition could be materially adversely affected.

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

To maintain and grow our market share, revenue, and brand, we must maintain and expand our sales channels. Our sales channels consist primarily of traditional retailers, online retailers, and wholesale distributors, but also include service providers such as wireless carriers and telecommunications providers. 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. A competitor with more extensive product lines and stronger brand identity 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. Our traditional retail customers have faced increased and significant competition from online retailers. If we cannot effectively manage our business amongst our online customers and traditional retail customers, our business would be harmed. The recent trend in the consolidation of online retailers has resulted in intensified competition for preferred product placement, such as product placement on an online retailer's internet home page. In addition, our efforts to realign or consolidate our sales channels may cause temporary disruptions in our product sales and revenue, and these efforts may not result in the expected longer-term benefits that prompted them.

In addition, to the extent our retail and distributor channel partners supply products that compete with our own, it is possible that these channel partners may choose not to offer our products to end-users or to offer our products to end-users on less favorable terms, including with respect to product placement. If this were to occur, we may not be able to increase or maintain our sales, and our business, results of operations, and financial condition could be materially adversely affected. For example, Amazon, one of our primary retailers, produces the Amazon Cloud Cam, which competes with our security camera products, and also recently acquired two of our competitors, Blink and Ring. For the three and nine months ended September 27, 2020, we derived 12.3% and 14.2% of our revenue from Amazon and its affiliates, respectively.

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, results of operations, and financial condition could be materially adversely affected.

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 distributors and within our sales channels, we may incur increased and unexpected costs associated with this inventory. We generally allow 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, thereby incurring incremental freight costs above the sea freight costs, a preferred method, and suffering a corresponding decline in gross margin.

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 likely have a more material effect on our business than a disruption 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, particularly in Europe, and we expect labor unrest and its effects on shipping our products to be a continuing challenge for us. A port worker strike, work slow-down, or other transportation disruption in Long Beach, California, where we import our products to fulfill our Americas orders, could significantly disrupt our business. Our international freight is regularly subjected to inspection by governmental entities. 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 extensive air freight to meet unexpected spikes in demand and shifts in demand between product categories, to bring new product introductions to market quickly and to timely ship products previously ordered. 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 materially adversely affect our business, results of operations, and financial condition.

If we are unable to secure and protect our intellectual property rights, our ability to compete could be harmed.

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 and technology. 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. 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 materially adversely affect our brand and business, results of operations, and financial condition.

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 into certain markets may be lower for potential or existing competitors than if we owned exclusive rights to the technology that we license and use. Moreover, 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 decides not to do business with us for any reason, our ability to develop and sell products containing that technology would be severely limited. In addition, certain of Arlo's firmware and the AI-based algorithms that we use in our Arlo Smart services incorporate open source software, the licenses for which may include customary requirements for, and restrictions on, use of the open source software.

If we are offering products or services that 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 or services. In addition, these licenses may require royalty payments or other consideration to the third-party licensor. Our success will depend, in part, on our continued ability to access these technologies, and we do not know whether these third-party technologies will continue to be licensed to us on commercially acceptable terms, if at all. In addition, if these third-party licensors fail or experience instability, then we may be unable to continue to sell products and services that incorporate the licensed technologies, in addition to being unable to continue to maintain and support these products and services. We do require escrow arrangements with respect to certain third-party software which entitle us to certain limited rights to the source code, in the event of certain failures by the third party, in order to maintain and support such software. However, there is no guarantee that we would be able to fully understand and use the source code, as we may not have the expertise to do so. We are increasingly exposed to these risks as we continue to develop and market more products containing third-party technology and software. If we are unable to license the necessary technology, we may be forced to acquire or develop alternative technology, which could be of lower quality or performance standards. The acquisition or development of alternative technology may limit and delay our ability to offer new or competitive products and services and increase our costs of production. As a result, our business, results of operations, and financial condition could be materially adversely affected.

We also utilize third-party software development companies and contractors to develop, customize, maintain, and support software that is incorporated into our products and services. If these companies and contractors fail to timely deliver or continuously maintain and support the software, as we require of them, we may experience delays in releasing new products and services or difficulties with supporting existing products, services, and our users.

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

International sales comprise a significant amount of our overall revenue. International sales were 33.0% and 23.3% of overall revenue in the three months ended September 27, 2020 and September 29, 2019, respectively, and 31.4% and 25.4% of overall revenue in the nine months ended September 27, 2020 and September 29, 2019. We continue to be committed to growing our international sales, and while we have committed resources to expanding our international operations and sales channels, these efforts may not be successful and could be impacted by COVID-19 pandemic. International operations are subject to a number of risks, including but not limited to:

- exchange rate fluctuations;

- political and economic instability, international terrorism, and anti-American sentiment, particularly in emerging markets;
- potential for violations of anti-corruption laws and regulations, such as those related to bribery and fraud;
- preference for locally branded products, and laws and business practices favoring local competition;
- potential consequences of, and uncertainty related to, the “Brexit” process in the United Kingdom, which could lead to additional expense and complexity in doing business there;
- 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 General Data Protection Regulation in the European Union, European competition law, the Restriction of Hazardous Substances directive, the Waste Electrical and Electronic Equipment directive and the European Ecodesign directive, that are costly to comply with and may vary from country to country;
- difficulties and costs of staffing and managing foreign operations;
- business difficulties, including potential bankruptcy or liquidation, of any of our worldwide third-party logistics providers; and
- changes in local tax and customs duty laws or changes in the enforcement, application, or interpretation of such laws.

We are also required to comply with local environmental legislation, and those who sell our products rely on this compliance in order to sell our products. If those who sell our products do not agree with our interpretations and requirements of new legislation, they may cease to order our products and our business, results of operations, and financial condition could be materially adversely affected.

The development of our operations and infrastructure in connection with our separation from NETGEAR, and any future expansion of such operations and infrastructure, may not be entirely successful, and may strain our operations and increase our operating expenses.

In connection with our separation from NETGEAR, we have been implementing a new information technology infrastructure for our business, which includes the creation of management information systems and operational and financial controls unique to our business. We may not be able to put in place adequate controls in an efficient and timely manner in connection with our separation from NETGEAR and as our business grows, 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 and operational and financial resources. In addition, as 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 and reorganization, our business could be harmed.

For example, we are investing significant capital and human resources in the design, development, and enhancement of our financial and enterprise resource planning systems. We will depend on these systems in order to timely and accurately process and report key components of our results of operations, financial condition, 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 development and enhancement of systems may be much more costly than we anticipated. If we are unable to continue to develop and enhance our information technology systems as planned, our business, results of operations, and financial condition could be materially adversely affected.

Governmental regulations of imports or exports affecting internet security could affect our 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, particularly 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 are involved in litigation matters in the ordinary course 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.

Our 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. From time to time, third parties 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 also include third-party non-practicing entities who claim to own patents or other intellectual property that they believe cover our products. 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 and litigation related to alleged infringement could materially adversely affect our business, results of operations, and financial condition.

In the event successful claims of infringement are brought by third parties, and we are unable to obtain licenses or independently develop alternative technology on a timely basis, we may be subject to indemnification obligations, be unable to offer competitive products, or be subject to increased expenses. If we do not resolve these claims on a favorable basis, our business, results of operations, and financial condition could be materially adversely affected.

As part of growing our business, we may make acquisitions. If we fail to successfully select, execute, or integrate our acquisitions, then our business, results of operations, and financial condition could be materially adversely affected and our stock price could decline.

From time to time, we may undertake acquisitions to add new product and service lines and technologies, acquire talent, gain new sales channels, or enter into new sales territories. Acquisitions involve numerous risks and challenges, including relating to the successful integration of the acquired business, entering into new territories or markets with which we have limited or no prior experience, establishing or maintaining business relationships with new retailers, distributors, or other channel partners, vendors, and suppliers, and potential post-closing disputes.

We cannot ensure that we will be successful in selecting, executing, and integrating acquisitions. Failure to manage and successfully integrate acquisitions could materially harm our business, financial condition, and results of

operations. 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.

The success of our business depends on customers' continued and unimpeded access to our platform on the internet.

Our users must have internet access in order to use our platform. Some providers may take measures that affect their customers' ability to use our platform, such as degrading the quality of the data packets we transmit over their lines, giving those packets lower priority, giving other packets higher priority than ours, blocking our packets entirely, or attempting to charge their customers more for using our platform.

In December 2010, the Federal Communications Commission (the "FCC"), adopted net neutrality rules barring internet providers from blocking or slowing down access to online content, protecting services like ours from such interference. Recently, the FCC voted in favor of repealing the net neutrality rules, and it is currently uncertain how the U.S. Congress will respond to this decision. To the extent network operators attempt to interfere with our services, extract fees from us to deliver our solution, or otherwise engage in discriminatory practices, our business, results of operations, and financial condition could be materially adversely affected. Within such a regulatory environment, we could experience discriminatory or anti-competitive practices that could impede our domestic and international growth, cause us to incur additional expense, or otherwise materially adversely affect our business, results of operations, and financial condition.

**** Changes in tax laws or exposure to additional income tax liabilities could affect our future profitability.***

Factors that could materially affect our future effective tax rates include, but are not limited to:

- changes in tax laws or the regulatory environment;
- changes in the valuation allowance against deferred tax assets;
- increases in interests and penalties related to income taxes;
- changes in accounting and tax standards or practices;
- changes in the composition of operating income by tax jurisdiction; and
- changes in our operating results before taxes.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Because we do not have a long history of operating as a separate company and we have significant expansion plans, our effective tax rate may fluctuate in the future. Future effective tax rates could be affected by operating losses in jurisdictions where no tax benefit can be recorded under GAAP, changes in the composition of earnings in countries with differing tax rates, changes in deferred tax assets and liabilities, or changes in tax laws.

As of December 31, 2019, our U.S. federal and state net operating loss carryforwards were approximately \$61.0 million and approximately \$45.4 million respectively. Moreover, our U.S. federal and state research and development tax credits were approximately \$1.6 million and approximately \$1.3 million, respectively. The utilization of our net operating loss and tax credit carryforwards may be subject to annual limitation due to ownership changes as provided by the Internal Revenue Code Sections 382 and 383 and similar state provisions. Such an annual limitation could result in the expiration of portions of our net operating loss and tax credit carryforwards before utilization. In the event that we experience ownership changes due to future transactions in our stocks, the utilization of net operating loss and tax credit carryforwards to reduce our future taxable income and tax liabilities may be limited.

The Internal Revenue Services ("IRS") and several foreign tax authorities have increasingly focused attention on intercompany transfer pricing with respect to sales of products and services and the use of intangibles. Tax authorities could disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. If we do not prevail in any such disagreements, our profitability may be affected.

In addition, the Organization for Economic Co-operation and Development ("OECD") have been working on new laws on the taxation of the digital economy to provide taxing rights to jurisdictions where the customers or users are located. Some countries have enacted, and others have proposed the new laws to tax digital transactions. These developments could result in material impacts to our financial statements.

We must comply with indirect tax laws in multiple jurisdictions, as well as complex customs duty regimes worldwide. Audits of our compliance with these rules may result in additional liabilities for taxes, duties, interest and penalties related to our international operations which would reduce our profitability.

Our operations are routinely subject to audit by tax authorities in various countries. Many countries have indirect tax systems where the sale and purchase of goods and services are subject to tax based on the transaction value. These taxes are commonly referred to as value-added tax ("VAT") or goods and services tax ("GST"). In addition, the distribution of our products subjects us to numerous complex customs regulations, which frequently change over time. Failure to comply with these systems and regulations can result in the assessment of additional taxes, duties, interest, and penalties. While we believe we are in compliance with local laws, we cannot assure that tax and customs authorities will agree with our reporting positions and upon audit such tax and customs authorities may assess additional taxes, duties, interest, and penalties against us.

Additionally, some of our products are subject to U.S. export controls, including the Export Administration Regulations and economic sanctions administered by the Office of Foreign Assets Control. We also incorporate encryption technology into certain of our solutions. These encryption solutions and underlying technology may be exported outside of the United States only with the required export authorizations or exceptions, including by license, a license exception, appropriate classification notification requirement, and encryption authorization.

Furthermore, our activities are subject to U.S. economic sanctions laws and regulations that prohibit the shipment of certain products and services without the required export authorizations, including to countries, governments, and persons targeted by U.S. embargoes or sanctions. Additionally, the Trump administration has been critical of existing trade agreements and may impose more stringent export and import controls. Obtaining the necessary export license or other authorization for a particular sale may be time consuming, and may result in delay or loss of sales opportunities even if the export license ultimately is granted. While we take precautions to prevent our solutions from being exported in violation of these laws, including using authorizations or exceptions for our encryption products and implementing IP address blocking and screenings against U.S. government and international lists of restricted and prohibited persons and countries, we have not been able to guarantee, and cannot guarantee, that the precautions we take will prevent all violations of export control and sanctions laws, including if purchasers of our products bring our products and services into sanctioned countries without our knowledge. Violations of U.S. sanctions or export control laws can result in significant fines or penalties and incarceration could be imposed on employees and managers for criminal violations of these laws.

Also, various countries, in addition to the United States, regulate the import and export of certain encryption and other technology, including import and export licensing requirements, and have enacted laws that could limit our ability to distribute our products and services or our end-users' ability to utilize our solutions in their countries. Changes in our products and services or changes in import and export regulations may create delays in the introduction of our products in international markets. Furthermore, recent actions by the Trump administration announcing increased duties on products imported from China may severely impact the price of our goods imported into the United States in the future, and other countries may follow suit and increase duties on goods produced in China.

Adverse action by any government agencies related to indirect tax laws could materially adversely affect our business, results of operations and financial condition.

We are subject to, and must remain in compliance with, numerous laws and governmental regulations concerning the manufacturing, use, distribution, and sale of our products, as well as any such future laws and regulations. Some of our customers also require that we comply with their own unique requirements relating to these matters. Any failure to comply with such laws, regulations, and requirements, and any associated unanticipated costs, could materially adversely affect our business, results of operations, and financial condition.

We manufacture and sell products which contain electronic components, and such components may contain materials that are subject to government regulation in both the locations where we manufacture and assemble our products, as well as the locations where we sell our products. For example, certain regulations limit the use of lead in electronic components. To our knowledge, we maintain compliance with all applicable current government regulations concerning the materials utilized in our products for all the locations in which we operate. Since we operate on a global basis, this is a complex process which requires continual monitoring of regulations and an ongoing compliance process to ensure that we and our suppliers are in compliance with all existing regulations. There are areas where new regulations have been enacted which could increase our cost of the components that we utilize or require us to expend additional resources to ensure compliance. For example, the SEC's "conflict minerals" rules apply to our business, and we are expending resources to ensure compliance. The implementation of these requirements by government regulators and our partners and/or customers could adversely affect the sourcing, availability and pricing of minerals used in the manufacture of certain components used in our products. In addition, the supply-chain due diligence investigation required by the conflict minerals rules will require expenditures of resources and management attention regardless of the results of the investigation. If there is an unanticipated new regulation which significantly impacts our use of various components or requires more expensive components, that regulation could materially adversely affect our business, results of operations, and financial condition.

One area that has a large number of regulations is environmental compliance. Management of environmental pollution and climate change has produced significant legislative and regulatory efforts on a global basis, and we believe this will continue both in scope and in the number of countries participating. These changes could directly increase the cost of energy, which may have an impact on the way we manufacture products or utilize energy to produce our products. In addition, any new regulations or laws in the environmental area might increase the cost of raw materials we use in our products. Environmental regulations require us to reduce product energy usage, monitor and exclude an expanding list of restricted substances, and participate in required recovery and recycling of our products. While future changes in regulations are certain, we are currently unable to predict how any such changes will impact us and if such impacts will be material to our business. If there is a new law or regulation that significantly increases our costs of manufacturing or causes us to significantly alter the way that we manufacture our products, this could have a material adverse effect on our business, financial condition, and results of operations.

Our selling and distribution practices are also regulated in large part by U.S. federal and state as well as foreign, antitrust and competition laws and regulations. In general, the objective of these laws is to promote and maintain free competition by prohibiting certain forms of conduct that tend to restrict production, raise prices or otherwise control the market for goods or services to the detriment of consumers of those goods and services. Potentially prohibited activities under these laws may include unilateral conduct or conduct undertaken as the result of an agreement with one or more of our suppliers, competitors, or customers. The potential for liability under these laws can be difficult to predict as it often depends on a finding that the challenged conduct resulted in harm to competition, such as higher prices, restricted supply, or a reduction in the quality or variety of products available to consumers. We utilize a number of different distribution channels to deliver our products to customers and end-users and regularly enter into agreements with resellers of our products at various levels in the distribution chain that could be subject to scrutiny under these laws in the event of private litigation or an investigation by a governmental competition authority. In addition, many of our products are sold to consumers via the internet. Many of the competition-related laws that govern these internet sales were adopted prior to the advent of the internet and, as a result, do not contemplate or address the unique issues raised by online sales. New interpretations of existing laws and regulations, whether by courts or by the state, federal, or foreign governmental authorities charged with the enforcement of those laws and regulations, may also impact our business in ways we are currently unable to predict. Any failure on our part or on the part of our employees, agents, distributors, or other business

partners to comply with the laws and regulations governing competition can result in negative publicity and diversion of management time and effort and may subject us to significant litigation liabilities and other penalties.

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

A substantial portion 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.

Any bankruptcies or illiquidity among our customer base could harm our business and have a material adverse effect on our financial condition and results of operations. To the degree that 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 materially adversely affect our business, results of operations, and financial condition.

If our products are not compatible with some or all leading third-party IoT products and protocols, we could be materially adversely affected.

A core part of our solution is the interoperability of our platform with third-party IoT products and protocols. The Arlo platform seamlessly integrates with third-party IoT products and protocols, such as Amazon Alexa, Apple HomeKit, Apple TV, Google Assistant, IFTTT, Stringify, and Samsung SmartThings. If these third parties were to alter their products, we could be adversely impacted if we fail to timely create compatible versions of our products, and such incompatibility could negatively impact the adoption of our products and solutions. A lack of interoperability may also result in significant redesign costs, and harm relations with our customers. Further, the mere announcement of an incompatibility problem relating to our products could materially adversely affect our business, results of operations, and financial condition.

In addition, to the extent our competitors supply products that compete with our own, it is possible these competitors could design their technologies to be closed or proprietary systems that are incompatible with our products or work less effectively with our products than their own. As a result, end-users may have an incentive to purchase products that are compatible with the products and technologies of our competitors over our products.

The marketability of our products may suffer if wireless telecommunications operators do not deliver acceptable wireless services.

The success of our business depends, in part, on the capacity, affordability, reliability, and prevalence of wireless data networks provided by wireless telecommunications operators and on which our IoT hardware products and solutions operate. Growth in demand for wireless data access may be limited if, for example, wireless telecommunications operators cease or materially curtail operations, fail to offer services that customers consider valuable at acceptable prices, fail to maintain sufficient capacity to meet demand for wireless data access, delay the expansion of their wireless networks and services, fail to offer and maintain reliable wireless network services, or fail to market their services effectively.

We are exposed to adverse currency exchange rate fluctuations in jurisdictions where we transact in local currency, which could materially adversely affect our business, results of operations, and financial condition.

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 financial condition, results of operations, and cash flows. Although a portion of our international sales are currently invoiced in U.S. dollars, we have implemented and continue to implement for certain countries and customers 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 primarily in Europe and Australia, as well

as our global operations, and non-U.S. dollar-denominated operating expenses and certain assets and liabilities. 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 established a hedging program after the IPO to hedge our exposure to fluctuations in foreign currency exchange rates as a response to the risk of changes in the value of foreign currency-denominated assets and liabilities. We may enter into foreign currency forward contracts or other instruments. We expect that such foreign currency forward contracts will reduce, but will not eliminate, the impact of currency exchange rate movements. For example, we may not execute forward contracts in all currencies in which we conduct business. In addition, we may hedge to reduce the impact of volatile exchange rates on revenue, gross profit and operating profit for limited periods of time. However, the use of these hedging activities may only offset a portion of the adverse financial effect resulting from unfavorable movements in foreign exchange rates.

Risks Related to Our Separation from NETGEAR

If the Distribution, together with certain related transactions, does not qualify as a transaction that is generally tax-free for U.S. federal income tax purposes, NETGEAR, Arlo and Arlo stockholders could be subject to significant tax liabilities, and, in certain circumstances, we could be required to indemnify NETGEAR for material taxes and other related amounts pursuant to indemnification obligations under the tax matters agreement.

NETGEAR received an opinion of counsel regarding qualification of the Distribution, together with certain related transactions, as a transaction that is generally tax-free for U.S. federal income tax purposes under Sections 355 and 368(a)(1)(D) of the Code. The opinion of counsel was based upon and relied on, among other things, certain facts and assumptions, as well as certain representations, statements and undertakings of NETGEAR and us, including those relating to the past and future conduct of NETGEAR and us. If any of these representations, statements or undertakings are, or become, incomplete or inaccurate, or if we or NETGEAR breach any of the respective covenants in any of the separation-related agreements, the opinion of counsel could be invalid and the conclusions reached therein could be jeopardized.

Notwithstanding the opinion of counsel, the IRS could determine that the Distribution, together with certain related transactions, should be treated as a taxable transaction if it were to determine that any of the facts, assumptions, representations, statements or undertakings upon which the opinion of counsel was based were false or had been violated, or if it were to disagree with the conclusions in the opinion of counsel. The opinion of counsel is not binding on the IRS or the courts, and we cannot assure that the IRS or a court would not assert a contrary position. NETGEAR has not requested, and does not intend to request, a ruling from the IRS with respect to the treatment of the Distribution or certain related transactions for U.S. federal income tax purposes.

If the Distribution, together with certain related transactions, were to fail to qualify as a transaction that is generally tax-free for U.S. federal income tax purposes under Sections 355 and 368(a)(1)(D) of the Code, in general, NETGEAR would recognize taxable gain as if it had sold our common stock in a taxable sale for its fair market value, and NETGEAR stockholders who receive shares of our common stock in the Distribution would be subject to tax as if they had received a taxable distribution equal to the fair market value of such shares.

We have agreed in the tax matters agreement entered into between us and NETGEAR to indemnify NETGEAR for any taxes (and any related costs and other damages) resulting from the Separation and Distribution, and certain other related transactions, to the extent such amounts were to result from (i) an acquisition after the Distribution of all or a portion of our equity securities, whether by merger or otherwise (and regardless of whether we facilitated the acquisition), (ii) other actions or failures to act by us or (iii) any of the representations or undertakings contained in any of the

Separation-related agreements or in the documents relating to the opinion of counsel being incorrect or violated. Any such indemnity obligations arising under the tax matters agreement could be material.

We may not be able to engage in desirable strategic or capital-raising transactions following the Distribution.

Under current law, a distribution that would otherwise qualify as a tax-free transaction, for U.S. federal income tax purposes, under Section 355 of the Code can be rendered taxable to the parent corporation and its stockholders as a result of certain post-distribution acquisitions of shares or assets of the distributed corporation. For example, such a distribution could result in taxable gain to the parent corporation under Section 355(e) of the Code if the distribution were later deemed to be part of a plan (or series of related transactions) pursuant to which one or more persons acquired, directly or indirectly, shares representing a 50% or greater interest (by vote or value) in the distributed corporation.

To preserve the tax-free treatment of the Separation and Distribution, and in addition to our expected indemnity obligations described above, we have agreed in the tax matters agreement to restrictions that address compliance with Section 355 (including Section 355(e)) of the Code. These restrictions, which generally will be effective during the two-year period following the Distribution, could limit our ability to pursue certain strategic transactions, equity issuances or repurchases or other transactions that we may believe to be in the best interests of our stockholders or that might increase the value of our business.

The assets and resources that we acquired from NETGEAR in the Separation may not be sufficient for us to operate as a standalone company, and we may experience difficulty in separating our assets and resources from NETGEAR.

Because we did not operate as an independent company prior to the Separation, we will need to acquire assets in addition to those contributed by NETGEAR and its subsidiaries to us and our subsidiaries in connection with the Separation. We may also face difficulty in separating our assets from NETGEAR's assets and integrating newly acquired assets into our business. Our business, financial condition and results of operations could be harmed if we fail to acquire assets that prove to be important to our operations or if we incur unexpected costs in separating our assets from NETGEAR's assets or integrating newly acquired assets.

The services that NETGEAR provides to us may not be sufficient to meet our needs, which may result in increased costs and otherwise adversely affect our business.

Pursuant to the transition services agreement entered into between us and NETGEAR, NETGEAR has agreed to continue, for a transitional period, to provide us with corporate and shared services related to corporate functions, such as executive oversight, risk management, information technology, accounting, audit, legal, investor relations, tax, treasury, shared facilities, engineering, operations, customer support, human resources and employee benefits, sales and sales operations, and other services in exchange for the fees specified in the transition services agreement. NETGEAR is not obligated to provide these services in a manner that differs from the nature of the services provided to the Arlo business during the 12-month period prior to the completion of the IPO, and thus we may not be able to modify these services in a manner desirable to us as a standalone public company. Further, once we no longer receive these services from NETGEAR, due to the termination or expiration of the transition services agreement or otherwise, we may not be able to perform these services ourselves and/or find appropriate third party arrangements at a reasonable cost (and any such costs may be higher than those charged by NETGEAR).

Our ability to operate our business effectively may suffer if we are unable to cost-effectively establish our own administrative and other support functions in order to operate as a standalone company after the expiration of our shared services and other intercompany agreements with NETGEAR.

As an operating segment of NETGEAR, we relied on administrative and other resources of NETGEAR, including information technology, accounting, finance, human resources and legal services, to operate our business. In connection with our IPO, we entered into various service agreements to retain the ability for specified periods to use these

NETGEAR resources. These services may not be provided at the same level as when we were a business segment within NETGEAR, and we may not be able to obtain the same benefits that we received prior to the completion of the IPO. These services may not be sufficient to meet our needs, and after our agreements with NETGEAR expire (which will generally occur within 18 months following the completion of the IPO, which occurred on August 7, 2018), we may not be able to replace these services at all or obtain these services at prices and on terms as favorable as those we currently have with NETGEAR. We will need to create our own administrative and other support systems or contract with third parties to replace NETGEAR's systems. Any failure or significant downtime in our own administrative systems or in NETGEAR's administrative systems during the transitional period could result in unexpected costs, impact our results and/or prevent us from paying our suppliers or employees and performing other administrative services on a timely basis.

We are a smaller company relative to our former parent, NETGEAR, which could result in increased costs in our supply chain and in general because of a decrease in our purchasing power as a result of the Separation. We may also experience decreased revenue due to difficulty maintaining existing customer relationships and obtaining new customers.

Prior to the completion of the IPO, we were able to take advantage of NETGEAR's size and purchasing power in procuring goods, technology and services, including insurance, employee benefit support, and audit and other professional services. In addition, as a segment of NETGEAR, we were able to leverage NETGEAR's size and purchasing power to bargain with suppliers of our components and our ODMs. We are a smaller company than NETGEAR, and we cannot assure you that we will have access to financial and other resources comparable to those that were available to us prior to the completion of the IPO. As a standalone company, we may be unable to obtain office space, goods, technology, and services in general, as well as components and services that are part of our supply chain, at prices or on terms as favorable as those that were available to us prior to the completion of the IPO, which could increase our costs and reduce our profitability. Our future success depends on our ability to maintain our current relationships with existing customers, and we may have difficulty attracting new customers due to our smaller size.

NETGEAR has agreed to indemnify us for certain liabilities. However, we cannot assure that the indemnity will be sufficient to insure us against the full amount of such liabilities, or that NETGEAR's ability to satisfy its indemnification obligation will not be impaired in the future.

Pursuant to the master separation agreement entered into between us and NETGEAR and certain other agreements with NETGEAR, NETGEAR has agreed to indemnify us for certain liabilities. The master separation agreement provides for cross-indemnities principally designed to place financial responsibility for the obligations and liabilities of our business with us and financial responsibility for the obligations and liabilities of NETGEAR's business with NETGEAR. Under the intellectual property rights cross-license agreement entered into between us and NETGEAR, each party, in its capacity as a licensee, indemnifies the other party, in its capacity as a licensor, as well as its directors, officers, agents, successors and subsidiaries against any losses suffered by such indemnified party as a result of the indemnifying party's practice of the intellectual property licensed to such indemnifying party under the intellectual property rights cross-license agreement. Also, under the tax matters agreement entered into between us and NETGEAR, each party is liable for, and indemnifies the other party and its subsidiaries from and against any liability for, taxes that are allocated to such party under the tax matters agreement. In addition, we have agreed in the tax matters agreement that each party will generally be responsible for any taxes and related amounts imposed on us or NETGEAR as a result of the failure of the Distribution, together with certain related transactions, to qualify as a transaction that is generally tax-free, for U.S. federal income tax purposes, under Sections 355 and 368(a)(1)(D) and certain other relevant provisions of the Code, to the extent that the failure to so qualify is attributable to actions, events or transactions relating to such party's respective stock, assets or business, or a breach of the relevant representations or covenants made by that party in the tax matters agreement. The transition services agreement generally provides that the applicable service recipient indemnifies the applicable service provider for liabilities that such service provider incurs arising from the provision of services other than liabilities arising from such service provider's gross negligence, bad faith or willful misconduct or material breach of the transition services agreement, and that the applicable service provider indemnifies the applicable service recipient for liabilities that such service recipient incurs arising from such service provider's gross negligence, bad faith or willful misconduct or material breach of the transition services agreement. Pursuant to the registration rights agreement, we have agreed to indemnify

NETGEAR and its subsidiaries that hold registrable securities (and their directors, officers, agents and, if applicable, each other person who controls such holder under Section 15 of the Securities Act) registering shares pursuant to the registration rights agreement against certain losses, expenses and liabilities under the Securities Act, common law or otherwise. NETGEAR and its subsidiaries that hold registrable securities similarly indemnify us but such indemnification will be limited to an amount equal to the net proceeds received by such holder under the sale of registrable securities giving rise to the indemnification obligation.

However, third parties could also seek to hold us responsible for any of the liabilities that NETGEAR has agreed to retain, and we cannot assure that an indemnity from NETGEAR will be sufficient to protect us against the full amount of such liabilities, or that NETGEAR will be able to fully satisfy its indemnification obligations in the future. Even if we ultimately succeed in recovering from NETGEAR any amounts for which we are held liable, we may be temporarily required to bear these losses. Each of these risks could materially adversely affect our business, results of operations, and financial condition.

We may have received better terms from unaffiliated third parties than the terms we received in the agreements that we entered into with NETGEAR in connection with the Separation.

The agreements that we entered into with NETGEAR in connection with the Separation, including the master separation agreement, the transition services agreement, the intellectual property cross-license agreement, the tax matters agreement, the employee matters agreement and the registration rights agreement with respect to NETGEAR's continuing ownership of our common stock, were prepared in the context of the Separation while we were still a wholly owned subsidiary of NETGEAR. Accordingly, during the period in which the terms of those agreements were prepared, we did not have a board of directors or a management team that was independent of NETGEAR. As a result, the terms of those agreements may not reflect terms that would have resulted from arm's-length negotiations between unaffiliated third parties.

Risks Related to Ownership of Our Common Stock

The market price of our common stock could be volatile and is influenced by many factors, some of which are beyond our control.

The market price of our common stock could be volatile and is influenced by many factors, some of which are beyond our control, including those described above in "Risks Related to Our Business" and the following:

- the failure of securities analysts to cover our common stock or changes in financial estimates by analysts;
- the inability to meet the financial estimates of securities analysts who follow our common stock or changes in earnings estimates by analysts;
- strategic actions by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- our quarterly or annual earnings, or those of other companies in our industry;
- actual or anticipated fluctuations in our operating results and those of our competitors;
- general economic and stock market conditions;
- the public reaction to our press releases, our other public announcements and our filings with the SEC;

- risks related to our business and our industry, including those discussed above;
- changes in conditions or trends in our industry, markets or customers;
- the trading volume of our common stock;
- future sales of our common stock or other securities; and
- investor perceptions of the investment opportunity associated with our common stock relative to other investment alternatives.

In particular, the realization of any of the risks described in these “*Risk Factors*” could have a material adverse impact on the market price of our common stock in the future and cause the value of your investment to decline. In addition, the stock market in general has experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market and industry factors may materially reduce the market price of our common stock, regardless of our operating performance. In addition, price volatility may be greater if the public float and trading volume of our common stock is low.

We may change our dividend policy at any time.

Although we currently intend to retain future earnings to finance the operation and expansion of our business and therefore do not anticipate paying cash dividends on our capital stock in the foreseeable future, our dividend policy may change at any time without notice to our stockholders. The declaration and amount of any future dividends to holders of our common stock will be at the discretion of our board of directors in accordance with applicable law and after taking into account various factors, including our financial condition, results of operations, current and anticipated cash needs, cash flows, impact on our effective tax rate, indebtedness, contractual obligations, legal requirements, and other factors that our board of directors deems relevant. As a result, we cannot assure you that we will pay dividends at any rate or at all.

****Future sales, or the perception of future sales, of our common stock may depress the price of our common stock.***

The market price of our common stock could decline significantly as a result of sales or other distributions of a large number of shares of our common stock in the market. The perception that these sales might occur could depress the market price of our common stock. These sales, or the possibility that these sales may occur, might also make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

The 11,747,250 shares of our common stock sold in the IPO are freely tradable in the public market. On December 31, 2018, NETGEAR completed the Distribution to its stockholders of the 62,500,000 shares of Arlo common stock that it owned. As of September 27, 2020, we have 79,026,508 shares of common stock outstanding.

In the future, we may issue our securities in connection with investments or acquisitions. The amount of shares of our common stock issued in connection with an investment or acquisition could constitute a material portion of our then-outstanding shares of our common stock.

Our costs will increase significantly as a result of operating as a public company, and our management will be required to devote substantial time to complying with public company regulations.

Prior to the Separation, we historically operated our business as a segment of a public company. As a standalone public company, we have additional legal, accounting, insurance, compliance, and other expenses that we had not incurred historically. We are now obligated to file with the SEC annual and quarterly reports and other reports that are specified in Section 13 and other sections of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We are also required to ensure that we have the ability to prepare financial statements that are fully compliant with all SEC reporting

requirements on a timely basis. In addition, we are and will continue to become subject to other reporting and corporate governance requirements, including certain requirements of the NYSE, and certain provisions of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) and the regulations promulgated thereunder, which will impose significant compliance obligations upon us.

Sarbanes-Oxley, as well as rules subsequently implemented by the SEC and the NYSE, have imposed increased regulation and disclosure and required enhanced corporate governance practices of public companies. We are committed to maintaining high standards of corporate governance and public disclosure, and our efforts to comply with evolving laws, regulations and standards in this regard are likely to result in increased selling and administrative expenses and a diversion of management’s time and attention from revenue-generating activities to compliance activities. These changes will require a significant commitment of additional resources. We may not be successful in implementing these requirements and implementing them could materially adversely affect our business, results of operations and financial condition. In addition, if we fail to implement the requirements with respect to our internal accounting and audit functions, our ability to report our operating results on a timely and accurate basis could be impaired. If we do not implement such requirements in a timely manner or with adequate compliance, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC and the NYSE. Any such action could harm our reputation and the confidence of investors and customers in us and could materially adversely affect our business and cause our share price to fall.

****Any impairment of goodwill, other intangible assets, and long-lived assets could negatively impact our results of operations.***

Under generally accepted accounting principles, we review our intangible assets and long-lived 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, other intangible assets and long-lived 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.

If, in any period our stock price decreases to the point where the fair value of our assets (as partially indicated by our market capitalization) is less than our book value, this could indicate a potential impairment and we may be required to record an impairment charge in that period. 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, other intangible assets and long-lived assets be determined resulting in an adverse impact on our results of operations. If there is a further decline in the Company’s stock price based on market conditions and deterioration of the Company’s business, the Company may have to record a charge to its earnings for the associated goodwill impairment of up to \$11.0 million.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley could materially adversely affect our business, results of operations, financial condition, and stock price.

As a public company, we are required to document and test our internal control procedures in order to satisfy the requirements of Section 404 of Sarbanes-Oxley (“Section 404”), which will require annual management assessments of the effectiveness of our internal control over financial reporting beginning with our annual report on Form 10-K for the year ended December 31, 2019. Upon loss of status as an “emerging growth company” as defined in the Jumpstart Our Business Startups Act (“JOBS Act”), an annual report by our independent registered public accounting firm that addresses the effectiveness of internal control over financial reporting will be required. During the course of our testing, we may identify deficiencies which we may not be able to remediate in time to meet our deadline for compliance with Section 404. Testing and maintaining internal control can divert our management’s attention from other matters that are important to the operation of our business. We also expect the regulations under Sarbanes-Oxley to increase our legal and financial compliance costs, make it more difficult to attract and retain qualified officers and members of our board of directors, particularly to serve on our audit committee, and make some activities more difficult, time consuming, and costly. We may

not be able to conclude on an ongoing basis that we have effective internal control over our financial reporting in accordance with Section 404 or our independent registered public accounting firm may not be able or willing to issue an unqualified report on the effectiveness of our internal control over financial reporting. If we conclude that our internal control over financial reporting is not effective, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or their effect on our operations because there is presently no precedent available by which to measure compliance adequacy. If either we are unable to conclude that we have effective internal control over our financial reporting or our independent auditors are unable to provide us with an unqualified report as required by Section 404, then investors could lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

If securities or industry analysts do not publish research or reports about our business, if they adversely change their recommendations regarding our stock, or if our operating results do not meet their expectations, our stock price could decline.

The trading market for our common stock will be influenced by the research, reports and recommendations that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. Moreover, if one or more of the analysts who cover us downgrades our stock or if our operating results do not meet their expectations, our stock price could decline.

We are subject to securities class action and derivative litigation.

We are subject to various securities class action and derivative complaints, as more fully discussed in the heading under “Litigation and Other Legal Matters” in Note 10, *Commitments and Contingencies*, in Notes to Unaudited Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Regardless of the merits or ultimate results of the above-described litigation matters, they could result in substantial costs, which would hurt the Company's financial condition and results of operations and divert management's attention and resources from our business. At this point, however, it is too early to reasonably estimate any financial impact to the Company resulting from these litigation matters.

Your percentage ownership in Arlo may be diluted in the future.

In the future, your percentage ownership in Arlo may be diluted because of equity awards that Arlo may grant to Arlo's directors, officers, and employees or otherwise as a result of equity issuances for acquisitions or capital market transactions. In addition, following the Distribution, Arlo and NETGEAR employees hold awards in respect of shares of our common stock as a result of the conversion of certain NETGEAR stock awards (in whole or in part) to Arlo stock awards in connection with the Distribution. Such awards have a dilutive effect on Arlo's earnings per share, which could adversely affect the market price of Arlo common stock. From time to time, Arlo will issue additional stock-based awards to its employees under Arlo's employee benefits plans.

In addition, Arlo's amended and restated certificate of incorporation authorizes Arlo to issue, without the approval of Arlo's stockholders, one or more classes or series of preferred stock having such designation, powers, preferences and relative, participating, optional and other special rights, including preferences over Arlo's common stock respecting dividends and distributions, as Arlo's board of directors generally may determine. The terms of one or more classes or series of preferred stock could dilute the voting power or reduce the value of our common stock. For example, Arlo could grant the holders of preferred stock the right to elect some number of Arlo's directors in all events or on the happening of specified events or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences that Arlo could assign to holders of preferred stock could affect the residual value of the common stock.

We are an emerging growth company, and we cannot be certain if the reduced reporting requirements applicable to emerging growth companies will make our common shares less attractive to investors.

We are an “emerging growth company,” as defined in the JOBS Act. For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including exemption from compliance with the auditor attestation requirements of Section 404, reduced disclosure obligations regarding executive compensation and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We will remain an emerging growth company until the earliest of (1) December 31, 2023, (2) the last day of the fiscal year in which we have total annual revenue of at least \$1.07 billion, (3) the last day of the fiscal year in which we become a large accelerated filer, which means that we have been public for at least 12 months, have filed at least one annual report and the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last day of our then most recently completed second fiscal quarter, or (4) the date on which we have issued more than \$1.0 billion in non-convertible debt during the prior three-year period.

Even after we no longer qualify as an emerging growth company, we may still qualify as a “smaller reporting company,” which would allow us to take advantage of many of the same exemptions from disclosure requirements including exemption from compliance with the auditor attestation requirements of Section 404 and reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements.

We cannot predict if investors will find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our share price may be more volatile.

Certain provisions in our amended and restated certificate of incorporation and amended and restated bylaws and of Delaware law may prevent or delay an acquisition of Arlo, which could decrease the trading price of our common stock.

Our amended and restated certificate of incorporation and amended and restated bylaws contain, and Delaware law contains, provisions that are intended to deter coercive takeover practices and inadequate takeover bids by making such practices or bids unacceptably expensive to the bidder and to encourage prospective acquirers to negotiate with our board of directors rather than to attempt a hostile takeover. These provisions include, among others:

- the inability of our stockholders to call a special meeting;
- the inability of our stockholders to act without a meeting of stockholders;
- rules regarding how stockholders may present proposals or nominate directors for election at stockholder meetings;
- the right of our board of directors to issue preferred stock without stockholder approval;
- the division of our board of directors into three classes of directors, with each class serving a staggered three-year term, and this classified board provision could have the effect of making the replacement of incumbent directors more time consuming and difficult;
- a provision that stockholders may only remove directors with cause while the board of directors is classified; and
- the ability of our directors, and not stockholders, to fill vacancies on our board of directors.

In addition, because we have not elected to be exempt from Section 203 of the Delaware General Corporation Law (the “DGCL”), this provision could also delay or prevent a change of control that you may favor. Section 203 provides that, subject to limited exceptions, persons that acquire, or are affiliated with a person that acquires, more than 15% of the outstanding voting stock of a Delaware corporation (an “interested stockholder”) shall not engage in any business combination with that corporation, including by merger, consolidation or acquisitions of additional shares, for a three-year period following the date on which the person became an interested stockholder, unless (i) prior to such time, the board of directors of such corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder; (ii) upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of such corporation at the time the transaction commenced (excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder) the voting stock owned by directors who are also officers or held in employee benefit plans in which the employees do not have a confidential right to tender or vote stock held by the plan); or (iii) on or subsequent to such time the business combination is approved by the board of directors of such corporation and authorized at a meeting of stockholders by the affirmative vote of at least two-thirds of the outstanding voting stock of such corporation not owned by the interested stockholder.

We believe these provisions will protect our stockholders from coercive or otherwise unfair takeover tactics by requiring potential acquirers to negotiate with our board of directors and by providing our board of directors with more time to assess any acquisition proposal. These provisions are not intended to make Arlo immune from takeovers. However, these provisions will apply even if the offer may be considered beneficial by some stockholders and could delay or prevent an acquisition that our board of directors determines is not in the best interests of Arlo and its stockholders. These provisions may also prevent or discourage attempts to remove and replace incumbent directors.

****Our amended and restated certificate of incorporation contains exclusive forum provisions that may discourage lawsuits against us and our directors and officers.***

Our amended and restated certificate of incorporation provides that unless the board of directors otherwise determines, the state courts in the State of Delaware or, if no state court located within the State of Delaware has jurisdiction, the federal court for the District of Delaware, will be the sole and exclusive forum for the following types of actions or proceedings under Delaware statutory or common law: any derivative action or proceeding brought on behalf of Arlo, any action asserting a claim of breach of a fiduciary duty owed by any director or officer of Arlo to Arlo or Arlo’s stockholders, any action asserting a claim against Arlo or any director or officer of Arlo arising pursuant to any provision of the DGCL or Arlo’s amended and restated certificate of incorporation or bylaws, or any action asserting a claim against Arlo or any director or officer of Arlo governed by the internal affairs doctrine under Delaware law. This provision would not apply to suits brought to enforce a duty or liability created by the Exchange Act. Furthermore, Section 22 of the Securities Act creates concurrent jurisdiction for federal and state courts over all such Securities Act actions. Accordingly, both state and federal courts have jurisdiction to entertain such claims. To prevent having to litigate claims in multiple jurisdictions and the threat of inconsistent or contrary rulings by different courts, among other considerations, our amended and restated certificate of incorporation further provides that the federal district courts of the United States will be the exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act. While the Delaware courts have determined that such choice of forum provisions are facially valid, a stockholder may nevertheless seek to bring a claim in a venue other than those designated in the exclusive forum provisions. In such instance, we would expect to vigorously assert the validity and enforceability of the exclusive forum provisions of our amended and restated certificate of incorporation. This may require significant additional costs associated with resolving such action in other jurisdictions and there can be no assurance that the provisions will be enforced by a court in those other jurisdictions. These exclusive forum provisions may limit the ability of Arlo’s stockholders to bring a claim in a judicial forum that such stockholders find favorable for disputes with Arlo or Arlo’s directors or officers, which may discourage such lawsuits against Arlo and Arlo’s directors and officers. Alternatively, if a court were to find one or more of these exclusive forum provisions inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings described above, Arlo may incur further significant additional costs associated with resolving such matters in other jurisdictions or forums, all of which could materially and adversely affect Arlo’s business, financial condition, or results of operations.

Our board of directors has the ability to issue blank check preferred stock, which may discourage or impede acquisition attempts or other transactions.

Our board of directors has the power, subject to applicable law, to issue series of preferred stock that could, depending on the terms of the series, impede the completion of a merger, tender offer or other takeover attempt. For instance, subject to applicable law, a series of preferred stock may impede a business combination by including class voting rights, which would enable the holder or holders of such series to block a proposed transaction. Our board of directors will make any determination to issue shares of preferred stock on its judgment as to our and our stockholders' best interests. Our board of directors, in so acting, could issue shares of preferred stock having terms which could discourage an acquisition attempt or other transaction that some, or a majority, of the stockholders may believe to be in their best interests or in which stockholders would have received a premium for their stock over the then prevailing market price of the stock.

Item 6. Exhibits
Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	Date	Number	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of Arlo Technologies, Inc.	8-K	8/7/2018	3.1	
3.2	Amended and Restated Bylaws of Arlo Technologies, Inc.	8-K	8/7/2018	3.2	
4.1	Common Stock Certificate of Arlo Technologies, Inc.	S-1/A	7/23/2018	4.1	
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer				X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer				X
32.1#	Section 1350 Certification of Principal Executive Officer				X
32.2#	Section 1350 Certification of Principal Financial Officer				X
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.				X
101.SCH	Inline XBRL Taxonomy Extension Schema Document				X
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document				X
104	104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)				X
#	This certification is deemed to accompany this Quarterly Report on Form 10-Q and will not be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or otherwise subject to the liabilities of that section. This certification will not be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.				

SIGNATURES

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

ARLO TECHNOLOGIES, INC.

Registrant

/s/ MATTHEW MCRAE

Matthew McRae
Chief Executive Officer
(Principal Executive Officer)

/s/ GORDON MATTINGLY

Gordon Mattingly
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 5, 2020

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Matthew McRae, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arlo Technologies, Inc. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting;
and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: November 5, 2020

/s/ MATTHEW MCRAE

Matthew McRae
Chief Executive Officer
Arlo Technologies, Inc.

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Gordon Mattingly, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arlo Technologies, Inc. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting;
and
5. The Registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: November 5, 2020

/s/ GORDON MATTINGLY

Gordon Mattingly

Chief Financial Officer

Arlo Technologies, Inc.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Arlo Technologies, Inc. (the "Company") on Form 10-Q for the period ended September 27, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Matthew McRae, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 5, 2020

By: /s/ MATTHEW MCRAE
Matthew McRae
Chief Executive Officer
Arlo Technologies, Inc.

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Form 10-Q), irrespective of any general incorporation language contained in such filing.

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Arlo Technologies, Inc. (the "Company") on Form 10-Q for the period ended September 27, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gordon Mattingly, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 5, 2020

By: /s/ GORDON MATTINGLY

Gordon Mattingly
Chief Financial Officer
Arlo Technologies, Inc.

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Form 10-Q), irrespective of any general incorporation language contained in such filing.