

HARMONIC INC  
Form 10-Q  
May 11, 2011

**Table of Contents**

**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 April 1, 2011**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File No. 000-25826**

**HARMONIC INC.**  
**(Exact name of registrant as specified in its charter)**

**Delaware**

**77-0201147**

**(State or other jurisdiction of  
incorporation or organization)**

**(I.R.S. Employer  
Identification Number)**

**4300 North First Street  
San Jose, CA 95134  
(408) 542-2500**

**(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

**Yes  No**

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

**Yes  No**

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller  
reporting company)

Smaller reporting  
company

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 shares of the registrant's Common Stock, \$.001 par value, outstanding on April 25, 2011 was 114,791,066.



**TABLE OF CONTENTS**

**PART I**

**ITEM 1. FINANCIAL STATEMENTS**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**ITEM 4. CONTROLS AND PROCEDURES**

**PART II**

**ITEM 1. LEGAL PROCEEDINGS**

**ITEM 1A. RISK FACTORS**

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

**ITEM 5. OTHER INFORMATION**

**SIGNATURES**

**EX-10.44**

**EX-31.1**

**EX-31.2**

**EX-32.1**

**EX-32.2**

**EX-101 INSTANCE DOCUMENT**

**EX-101 SCHEMA DOCUMENT**

**EX-101 CALCULATION LINKBASE DOCUMENT**

**EX-101 LABELS LINKBASE DOCUMENT**

**EX-101 PRESENTATION LINKBASE DOCUMENT**

---

**Table of Contents****PART I****FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**HARMONIC INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)**

	<b>April 1, 2011</b>	<b>December 31, 2010</b>
	(In thousands, except par value amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 59,672	\$ 96,533
Short-term investments	57,614	23,838
Accounts receivable, net of allowances of \$5,387 and \$5,897 at April 1, 2011 and December 31, 2010, respectively	111,929	101,652
Inventories	58,817	58,065
Deferred income taxes	39,849	39,849
Prepaid expenses and other current assets	28,218	28,614
<b>Total current assets</b>	<b>356,099</b>	<b>348,551</b>
Property and equipment, net	39,597	39,825
Goodwill	212,214	211,878
Intangibles, net	110,700	118,070
Other assets	1,988	2,062
<b>Total assets</b>	<b>\$ 720,598</b>	<b>\$ 720,386</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 22,197	\$ 26,300
Income taxes payable	781	6,791
Deferred revenue	49,815	46,279
Accrued liabilities	39,379	51,283
<b>Total current liabilities</b>	<b>112,172</b>	<b>130,653</b>
Accrued excess facility costs, long-term	1,361	1,153
Income taxes payable, long-term	48,139	48,883
Deferred income taxes, long-term	15,635	14,849
Other non-current liabilities	6,539	4,645
<b>Total liabilities</b>	<b>183,846</b>	<b>200,183</b>

## Commitments and contingencies (Notes 14 and 15)

## Stockholders' equity:

Preferred stock, \$0.001 par value, 5,000 shares authorized; no shares issued or outstanding

Common stock, \$0.001 par value, 150,000 shares authorized; 114,723 and 112,360 shares issued and outstanding at April 1, 2011 and

December 31, 2010, respectively

Capital in excess of par value

Accumulated deficit

Accumulated other comprehensive loss

Total stockholders' equity

Total liabilities and stockholders' equity

115	112
2,413,258	2,397,671
(1,876,352)	(1,876,868)
(269)	(712)
536,752	520,203
\$ 720,598	\$ 720,386

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

**Table of Contents**

**HARMONIC INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except per share amounts)	
Product revenue	\$ 115,867	\$ 74,434
Service revenue	16,968	10,388
Net revenue	132,835	84,822
Product cost of revenue	64,751	41,010
Service cost of revenue	6,229	3,006
Total cost of revenue	70,980	44,016
Gross profit	61,855	40,806
Operating expenses:		
Research and development	26,149	16,966
Selling, general and administrative	33,564	20,845
Amortization of intangibles	2,229	534
Total operating expenses	61,942	38,345
Income (loss) from operations	(87)	2,461
Interest income, net	92	384
Other expense, net	(107)	(371)
Income (loss) before income taxes	(102)	2,474
Benefit from income taxes	(618)	(2,845)
Net income	\$ 516	\$ 5,319
Net income per share:		
Basic	\$ 0.00	\$ 0.06
Diluted	\$ 0.00	\$ 0.05
Weighted average shares:		

Edgar Filing: HARMONIC INC - Form 10-Q

Basic	113,836	96,684
Diluted	116,109	97,344

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

3

---



**Table of Contents**

**HARMONIC INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	<b>Three months ended</b>	
	<b>April 1,</b>	<b>April 2, 2010</b>
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 516	\$ 5,319
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of intangibles	7,371	2,616
Depreciation	3,403	2,333
Stock-based compensation	6,002	3,243
Net loss on disposal of fixed assets	61	19
Deferred income taxes	76	(1,422)
Other non-cash adjustments, net	121	567
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	(10,277)	(5,204)
Inventories	(732)	(4,512)
Prepaid expenses and other assets	998	(1,101)
Accounts payable	(3,616)	(3,356)
Deferred revenue	4,430	6,445
Income taxes payable	(6,748)	(1,616)
Accrued excess facility costs	46	(1,697)
Accrued and other liabilities	(9,334)	(4,613)
Net cash used in operating activities	(7,683)	(2,979)
Cash flows from investing activities:		
Purchases of investments	(41,813)	(35,367)
Proceeds from maturities of investments	6,873	41,292
Proceeds from sales of investments	1,026	
Acquisition of property and equipment	(4,957)	(1,153)
Net cash provided by (used in) investing activities	(38,871)	4,772
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	9,570	1,736
Net cash provided by financing activities	9,570	1,736
Effect of exchange rate changes on cash and cash equivalents	123	(46)
Net increase (decrease) in cash and cash equivalents	(36,861)	3,483

Edgar Filing: HARMONIC INC - Form 10-Q

Cash and cash equivalents at beginning of period	96,533	152,477
Cash and cash equivalents at end of period	\$ 59,672	\$ 155,960
Supplemental disclosures of cash flow information:		
Income tax payments, net	\$ 4,368	\$ 191

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

4

---

**Table of Contents**

**HARMONIC INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1: BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation.* The accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. ( Harmonic, or the Company ) considers necessary for a fair presentation of the results of operations for the interim periods covered and the consolidated financial condition of the Company at the date of the balance sheets. This Quarterly Report on Form 10-Q should be read in conjunction with the Company s audited consolidated financial statements contained in the Company s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 1, 2011 ( 2010 Form 10-K ). The interim results presented herein are not necessarily indicative of the results of operations that may be expected for the full fiscal year ending December 31, 2011, or any other future period. The Company s fiscal quarters are based on 13-week periods, except for the fourth quarter which ends on December 31.

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ( US GAAP ).

*Use of Estimates.* The preparation of the consolidated financial statements in conformity with US 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

*Significant Accounting Policies.* The Company s significant accounting policies are described in Note 1 to its audited Consolidated Financial Statements included in its 2010 Form 10-K. With the exception of revenue recognition discussed below, there have been no significant changes to these policies and no recent accounting pronouncements or changes in accounting pronouncements, during the three months ended April 1, 2011, that are of significance or potential significance to the Company.

*Revenue Recognition.* Harmonic s principal sources of revenue are from hardware products, software products, solution sales, services, and hardware and software maintenance contracts. Harmonic recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured.

Revenue from product sales, excluding the revenue generated from service-related solutions, which are discussed below, is recognized when risk of loss and title have transferred, which is generally upon shipment or delivery, or once all applicable criteria have been met. Allowances are provided for estimated returns and discounts. Such allowances are adjusted periodically to reflect actual and anticipated experience.

In October 2009, the Financial Accounting Standards Board (FASB) amended US GAAP accounting standards for revenue recognition to remove tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of industry-specific software revenue recognition guidance. US GAAP accounting standards for multiple deliverable revenue arrangements were also amended to:

provide updated guidance on how deliverables in a multiple element arrangement should be separated and how the consideration should be allocated;

**Table of Contents**

require an entity to allocate revenue in an arrangement using the best estimate of selling price (BESP) if a vendor does not have vendor-specific objective evidence (VSOE) of selling price or third-party evidence of selling price (TPE); and eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

Harmonic elected to adopt this accounting guidance prospectively, beginning with the quarter ended April 1, 2011, for applicable transactions originating or materially modified after December 31, 2010. Certain of Harmonic's hardware products contain software components that function together to provide the essential functionality of the product. Therefore, such product sales are removed from the industry-specific software revenue recognition guidance and, instead, are governed by the new amended standards.

For product sales subject to the amended guidance, the Company allocates the arrangement consideration to each unit of accounting on the basis of their relative selling price (the relative selling price method). When applying the relative selling price method, the company first considers VSOE of the selling price, if it exists; otherwise TPE of the selling price. If neither VSOE nor TPE exists for a deliverable, the Company uses BESP for that deliverable.

Harmonic has established VSOE for certain elements of its arrangements based on either historical stand-alone sales to third parties or substantive renewal rates for maintenance. The Company has VSOE of fair value for maintenance, training and certain professional services.

TPE is determined based on competitor prices for similar deliverables when sold separately. The Company is typically not able to determine TPE for their products or services. Generally, the Company's go-to-market strategy differs from that of their peers and the Company's offerings contain a significant level of differentiation, such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis.

When the Company is unable to establish fair value of non-software deliverables using VSOE or TPE, the Company uses BESP in their allocation of arrangement consideration. The objective of using BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for a product or service by considering multiple factors, including, but not limited to, pricing practices, market conditions, competitive landscape, internal costs, geographies and gross margin. The determination of BESP is made through consultation with Company's management, taking into consideration the Company's go-to-market strategy.

The Company regularly reviews BESP and maintains internal controls over establishing and updating these estimates. There has been no material impact during the quarter, and the Company does not anticipate a material impact in the near term, from changes in BESP. However, the Company may modify pricing practices in the future, which could result in changes in selling prices, including BESP. Accordingly, the impact on future revenue recognition for multiple deliverable arrangements could differ materially from the results in the current period.

Total revenue, as reported, and pro forma total revenue that would have been reported for the fiscal quarter ended April 1, 2011 if the transactions entered into after January 1, 2011 had been subject to previous accounting guidance, are shown in the following table:

	<b>Three months ended April 1, 2011</b>	
	<b>As Reported</b>	<b>Pro Forma</b>
	(In thousands)	
Net revenue	\$ 132,835	\$ 131,669

The impact of the revised accounting guidance on net revenue during the fiscal quarter ended April 1, 2011 was attributable to the ability to assign a relative selling price to undelivered elements, which previously required VSOE (such as undelivered firmware updates on hardware products), and the reallocation of consideration to revenue deliverables.

Sales of stand-alone software that are not considered essential to the functionality of the hardware continue to be subject to the industry-specific software revenue recognition guidance. The Company uses the residual method to recognize revenue for the

**Table of Contents**

delivered elements in stand-alone software transactions. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration, less the aggregate fair value of any undelivered elements, typically maintenance, provided that VSOE of fair value exists for all undelivered elements. VSOE of fair value is based on the price charged when the element is sold separately or substantive renewal rates for maintenance. Solution sales for the design, manufacture, test, integration and installation of products, including equipment acquired from third parties to be integrated with Harmonic's products, that are customized to meet the customer's specifications are accounted for in accordance with applicable guidance on accounting for performance of construction/production contracts. Accordingly, for each arrangement that the Company enters into that includes both products and services, the Company performs a detailed evaluation to determine whether the arrangement should be accounted for under guidance for construction/production contracts or, alternatively, for arrangements that do not involve significant production, modification or customization, under other applicable accounting guidance. The Company has a long-standing history of entering into contractual arrangements to deliver the solution sales described above and such arrangements represent a significant part of the operations of the Company.

At the outset of each arrangement accounted for as a single arrangement, the Company develops a detailed project plan and associated labor hour estimates for each project. The Company believes that, based on its historical experience, it has the ability to make labor cost estimates that are sufficiently dependable to justify the use of the percentage-of-completion method of accounting and, accordingly, utilizes percentage-of-completion accounting for most arrangements that are determined to be single arrangements. Under the percentage-of-completion method, revenue recognized reflects the portion of the anticipated contract revenue that has been earned, equal to the ratio of actual labor hours expended to total estimated labor hours to complete the project. If the estimated costs to complete a project exceed the total contract amount, indicating a loss, the entire anticipated loss is recognized.

Maintenance services are recognized straight-line over the maintenance term, which is typically one year. The unrecognized revenue portion of maintenance agreements billed is recorded as deferred revenue. The costs associated with services are recognized as incurred.

Deferred revenue includes billings in excess of revenue recognized, net of deferred cost of revenue, and invoiced amounts remain deferred until applicable revenue recognition criteria are met.

Revenue from distributors and system integrators is recognized on delivery, provided all other revenue recognition criteria have been met. The Company's agreements with these distributors and system integrators have terms which are generally consistent with the standard terms and conditions for the sale of the Company's equipment to end users and do not provide for product rotation or pricing allowances, as are typically found in agreements with stocking distributors. The Company accrues for sales returns and other allowances based on its historical experience.

Shipping and handling costs incurred for inventory purchases and product shipments are recorded in cost of revenue in the Company's Consolidated Statements of Operations.

**NOTE 2: OMNEON ACQUISITION****Omneon**

On September 15, 2010, Harmonic completed the acquisition of 100% of the equity interests of Omneon, Inc., a privately-held company organized under the laws of Delaware and headquartered in Sunnyvale, California. Omneon develops and supports a range of video servers, active storage systems and related software applications that media companies use to simultaneously ingest, process, store, manage and deliver digital media in a wide range of formats. When used for television production and on-air operations, the products are designed to provide continuous real-time record and playback capabilities, as well as file-based access to, and delivery of, digital media content. Omneon's products include Spectrum video servers, MediaGrid active storage systems, Media Application servers and other software applications that were initially designed for, and have been deployed mostly by, broadcasters that use Omneon's products for the production and transmission of television content.

The acquisition of Omneon was intended to strengthen Harmonic's competitive position in the digital media market and to broaden the Company's relationships with customers who produce and distribute digital video content, such as broadcasters, cable channels and other major owners of content. The acquisition was also intended to broaden Harmonic's technology and product lines with digital



**Table of Contents**

storage and playout solutions that complement Harmonic's existing video processing products. In addition, the acquisition provided an assembled workforce and the implicit value of future cost savings as a result of combining entities, and is expected to provide Harmonic with future unidentified new products and technologies. These opportunities were significant factors to the establishment of the purchase price, which exceeded the fair value of Omneon's net tangible and intangible assets acquired, resulting in goodwill of approximately \$147.5 million that was recorded in connection with this acquisition.

The purchase price, net of \$40.5 million of cash acquired, was \$251.3 million, which consisted of (i) approximately \$153.3 million in cash, net of cash acquired, (ii) 14.2 million shares of Harmonic common stock with a total fair value of approximately \$95.9 million, based on the price of Harmonic common stock at the time of close, and (iii) approximately \$2.1 million, representing the fair value attributed to shares of Omneon equity awards which Harmonic assumed and for which services had already been rendered as of the close of the acquisition. The cash portion of the purchase price was paid from existing cash balances. The Company also incurred a total of \$5.9 million of transaction expenses, which were expensed as selling, general and administrative expenses in the year ended December 31, 2010.

The assets and liabilities of Omneon were recorded at fair value at the date of acquisition. The Company will continue to evaluate certain assets and liabilities as new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. Changes to the assets and liabilities recorded may result in a corresponding adjustment to goodwill, and the measurement period will not exceed one year from the acquisition date. Further, any associated restructuring activities will be expensed in future periods and not recorded through purchase accounting as previously done under prior accounting guidance. There are no contingent consideration arrangements in connection with the acquisition.

The results of operations of Omneon are included in Harmonic's Consolidated Statements of Operations from September 15, 2010, the date of acquisition. The following table summarizes the allocation of the purchase price based on the fair value of the assets acquired and the liabilities assumed at the date of acquisition:

	(In thousands)
Cash acquired	\$ 40,485
Accounts receivable (Gross amount due from accounts receivable of \$17,760)	17,055
Inventory	11,010
Fixed assets	12,391
Deferred income tax assets	17,250
Other tangible assets acquired	3,294
Intangible assets:	
Existing technology	\$ 50,800
In-process technology	9,000
Patents/core technology	9,800
Customer contracts and related relationships	29,200
Trademarks and tradenames	4,000
Maintenance agreements and related relationships	5,500
Order backlog	800
	109,100
Goodwill	147,452
Total assets acquired	358,037
Accounts payable	(6,829)
Deferred revenue	(6,399)
Deferred income tax liabilities	(41,804)



Other accrued liabilities	(11,203)
Net assets acquired	291,802
Less: cash acquired	(40,485)
Net purchase price	\$ 251,317

**Table of Contents**

The purchase price set forth in the table above was allocated based on the fair value of the tangible and intangible assets acquired, and liabilities assumed, as of September 15, 2010. The Company used an overall discount rate of 15% to estimate the fair value of the intangible assets acquired, which was derived based on financial metrics of comparable companies operating in Omneon's industry. In determining the appropriate discount rates to use in valuing each of the individual intangible assets, the Company adjusted the overall discount rate giving consideration to the specific risk factors of each asset. The following methods were used to value the identified intangible assets:

The fair value of the existing technology assets acquired was established based on their highest and best use by a market participant using the Income Approach. The Income Approach included an analysis of the markets, cash flows and risks associated with achieving such cash flows to calculate the fair value;

As of the acquisition date, Omneon was developing new versions and incremental improvements to its 3G MediaPort product, which was expected to be used in the Spectrum product line, once completed. The in-process project was at a stage of development that required further research and development to determine technical feasibility and commercial viability. The fair value of the in-process technology assets acquired was based on the valuation premise that the assets would be In-Use using a discounted cash flow model;

The fair value of patents/core technology assets acquired was established based on a variation of the Income Approach called the Profit Allocation Method. In the Profit Allocation Method, we estimated the value of the patents/core technology by capitalizing the profits expected to be saved because Harmonic owns the technology;

The fair value of the customer contracts and related relationships assets acquired was based on the Income Approach;

The fair value of trade names/trademarks assets acquired was established based on the Profit Allocation Method;

The fair value of the maintenance agreements and related relationships assets acquired was based on the Income Approach; and

The fair value of backlog acquired was established based on the Income Approach.

Identified intangible assets are being amortized over the following useful lives:

Existing technology is estimated to have a useful life of four years;

In-process technology is being amortized upon completion over its projected remaining useful life, as assessed on the completion date. The completion of the in-process project was in the first quarter of 2011. The completed technology is estimated to have a useful life of four years;

Patents/core technology are being amortized over their estimated useful life of four years;

Customer contracts and related relationships are being amortized over their estimated useful life of six years;

Trade names/trademarks are being amortized over their estimated useful life of four years;

Maintenance agreements and related relationships are being amortized over their estimated useful life of six years; and

Order backlog was amortized over its estimated useful life of three and one half months.

The existing technology, patents/core technology, customer contracts and related relationships, maintenance agreements and related relationships, trade names/trademarks and backlog are amortized using the straight-line method, which reflects future projected cash flows.

The residual purchase price of \$147.5 million has been recorded as goodwill. The goodwill resulting from this acquisition is not deductible for federal tax purposes.

**Table of Contents**

Substantially all unvested stock options and unvested restricted stock units issued by Omneon and outstanding at closing were assumed by Harmonic. The exchange of stock-based compensation awards was treated as a modification under current accounting guidance. The calculation of the fair value of the exchanged awards immediately before and after the modification did not result in any significant incremental fair value. The fair value of Harmonic's stock options and restricted stock units issued to Omneon employees was \$17.3 million, which was determined using the Black-Scholes option pricing model, of which \$2.1 million represents purchase consideration and \$15.2 million will be recorded as compensation expense over the weighted average service period of 2.5 years.

**Pro Forma Financial Information**

The unaudited pro forma financial information presented below for the three months ended April 2, 2010 summarizes the combined results of operations as if the Omneon acquisition had been completed on January 1, 2010. The unaudited pro forma financial information for the three months ended April 2, 2010 combines the results for Harmonic for the three months ended April 2, 2010 and the historical results of Omneon for the three months ended March 31, 2010.

The pro forma financial information is presented for informational purposes only and does not purport to be indicative of what would have occurred had the merger actually been completed on such date or of results which may occur in the future.

	<b>Three months ended April 2, 2010</b> (In thousands, except per share amounts)
Net revenue	\$ 113,039
Net loss	(2,455)
Net loss per share – basic and diluted	(0.02)

**NOTE 3: FAIR VALUE**

The applicable accounting guidance establishes a framework for measuring fair value and expands required disclosure about the fair value measurements of assets and liabilities. This guidance requires the Company to classify and disclose assets and liabilities measured at fair value on a recurring basis, as well as fair value measurements of assets and liabilities measured on a nonrecurring basis in periods subsequent to initial measurement, in a three-tier fair value hierarchy as described below.

The guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes three levels of inputs that may be used to measure fair value:

- Level 1 – Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.
- Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company primarily uses broker quotes for valuation of its short-term investments.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company uses the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. During the three months ended April 1, 2011, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.



**Table of Contents**

The following table sets forth the fair value of the Company's financial assets measured at fair value on a recurring basis as of April 1, 2011 and December 31, 2010 based on the three-tier fair value hierarchy:

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	(In thousands)			
<b>April 1, 2011</b>				
Cash equivalents:				
Money market funds	\$ 18,284	\$	\$	\$ 18,284
Commercial paper		4,399		4,399
U.S. federal government bonds		4,003		4,003
Short-term investments:				
State, municipal and local government agencies bonds		34,264		34,264
Corporate bonds		16,526		16,526
Commercial paper		4,798		4,798
U.S. federal government bonds		2,026		2,026
<b>Total</b>	<b>\$ 18,284</b>	<b>\$ 66,016</b>	<b>\$</b>	<b>\$ 84,300</b>
<b>December 31, 2010</b>				
Cash equivalents:				
Money market funds	\$ 68,395	\$	\$	\$ 68,395
Short-term investments:				
State, municipal and local government agencies bonds		11,931		11,931
Corporate bonds		11,907		11,907
<b>Total</b>	<b>\$ 68,395</b>	<b>\$ 23,838</b>	<b>\$</b>	<b>\$ 92,233</b>

At April 1, 2011 and December 31, 2010, maturities of short-term investments are as follows:

	<b>April 1, 2011</b>	<b>December 31, 2010</b>
	(In thousands)	
<b>Short-term investments:</b>		
Less than one year	\$ 29,769	\$ 21,174
Due in 1 - 2 years	4,245	2,664
Due in 3 - 30 years	23,600	
<b>Total short-term investments</b>	<b>\$ 57,614</b>	<b>\$ 23,838</b>

The following is a summary of available-for-sale securities:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
	(In thousands)			
<b>April 1, 2011</b>				
	\$ 34,261	\$ 10	\$ (7)	\$ 34,264

State, municipal and local government agencies bonds					
U.S. federal government bonds	2,025	1			2,026
Corporate bonds	16,518	12	(4)		16,526
Commercial paper	4,797	1			4,798
Total	\$ 57,601	\$ 24	\$ (11)	\$	57,614

**December 31, 2010**

State, municipal and local government agencies bonds	\$ 11,915	\$ 20	\$ (4)	\$	11,931
Corporate bonds	11,894	20	(7)		11,907
Total	\$ 23,809	\$ 40	\$ (11)	\$	23,838

*Impairment of Investments*

Harmonic monitors its investment portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value; the Company's financial condition and business outlook, including key operational and cash flow metrics, current market conditions and future trends

**Table of Contents**

in the industry; and the Company's relative competitive position within the industry. At the present time, the Company does not intend to sell its investments that have unrealized losses in accumulated other comprehensive loss. In addition, the Company does not believe that it is more likely than not that it will be required to sell its investments that have unrealized losses in accumulated other comprehensive loss before the Company recovers the principal amounts invested. The Company believes that the unrealized losses are temporary and do not require an other-than-temporary impairment, based on our evaluation of available evidence as of April 1, 2011.

As of April 1, 2011, there were no individual available-for-sale securities in a material unrealized loss position and the amount of unrealized losses on the total investment balance was insignificant.

**NOTE 4: INVENTORIES**

The following is a summary of inventory as of April 1, 2011 and December 31, 2010:

	<b>April 1, 2011</b>	<b>December 31, 2010</b>
	(In thousands)	
<b>Inventories:</b>		
Raw materials	\$ 10,781	\$ 10,378
Work-in-process	3,057	2,324
Finished goods	44,979	45,363
	<b>\$ 58,817</b>	<b>\$ 58,065</b>

**NOTE 5: GOODWILL AND IDENTIFIED INTANGIBLES**

The following is a summary of goodwill and intangible assets as of April 1, 2011 and December 31, 2010:

	<b>April 1, 2011</b>			<b>December 31, 2010</b>		
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
	(In thousands)					
Identifiable intangibles:						
Existing and core technology	\$ 136,213	\$ (65,657)	\$ 70,556	\$ 127,146	\$ (60,453)	\$ 66,693
In-process technology				9,000		9,000
Customer relationships/contracts	67,100	(37,626)	29,474	67,098	(36,117)	30,981
Trademarks and tradenames	11,371	(6,480)	4,891	11,361	(6,060)	5,301
Supply agreements	3,432	(3,432)		3,414	(3,414)	
Maintenance agreements and related relationships	7,100	(1,321)	5,779	7,100	(1,008)	6,092
Software license, intellectual property and assembled workforce	309	(309)		309	(306)	3
Order backlog	2,800	(2,800)		2,800	(2,800)	
Subtotal of identifiable intangibles	228,325	(117,625)	110,700	228,228	(110,158)	118,070
Goodwill	212,214		212,214	211,878		211,878

Edgar Filing: HARMONIC INC - Form 10-Q

Total goodwill and other intangibles	\$ 440,539	\$ (117,625)	\$ 322,914	\$ 440,106	\$ (110,158)	\$ 329,948
--------------------------------------	------------	--------------	------------	------------	--------------	------------

The changes in the carrying amount of goodwill for the three months ended April 1, 2011 are as follows:

	(In thousands)
Balance at beginning of period	\$ 211,878
Adjustment to deferred tax asset associated with acquisition of Omneon	244
Foreign currency translation adjustment	92
 Balance at end of period	 \$ 212,214

For the three months ended April 1, 2011, the Company recorded a total of \$7.4 million of amortization expense for identified intangibles, of which \$5.1 million was included in cost of revenue. For the three months ended April 2, 2010, the Company recorded a total of \$2.6 million of amortization expense for identified intangibles, of which \$2.1 million was included in cost of revenue. The estimated future amortization expense of purchased intangible assets with definite lives is as follows:



**Table of Contents**

	<b>Cost of Revenue</b>	<b>Operating Expenses</b>	<b>Total</b>
		(In thousands)	
<b>Years ending December 31,</b>			
2011 (remaining 9 months)	\$ 16,361	\$ 6,678	\$ 23,039
2012	20,504	8,715	29,219
2013	19,232	8,096	27,328
2014	13,745	6,775	20,520
2015	714	5,783	6,497
2016		4,097	4,097
<b>Total</b>	<b>\$ 70,556</b>	<b>\$ 40,144</b>	<b>\$ 110,700</b>

**NOTE 6: RESTRUCTURING AND EXCESS FACILITIES**

In the second quarter of 2009, the Company recorded an excess facilities expense of \$0.3 million in selling, general and administrative expenses related to the closure of the Scopus New Jersey office. The lease term expired in April 2011.

In the fourth quarter of 2010, the Company recorded an excess facilities expense of \$3.0 million in selling, general and administrative expenses related to the closure of the Omneon headquarters in Sunnyvale, California. The charge was based on future rent payments, net of expected sublease income, to be made through the end of the lease term in June 2013. In the first quarter of 2011, the Company recorded an additional expense of \$0.5 million in selling, general and administrative expenses related to changes in expected sublease income for this property. Harmonic reassesses this liability quarterly and adjusts it, as necessary, based on changes in the timing and amounts of expected sublease rental income.

As of April 1, 2011, accrued excess facilities costs totaled \$3.0 million, of which \$1.6 million was included in current accrued liabilities. The Company incurred cash outlays of \$0.5 million related to vacated facilities during the first three months of 2011, principally for lease payments, property taxes, insurance and other maintenance fees.

The following table summarizes the activity in the restructuring accrual during the three months ended April 1, 2011:

	<b>Excess Facilities</b>
	(In thousands)
Balance at December 31, 2010	\$ 2,920
Provisions	517
Cash payments	(471)
<b>Balance at April 1, 2011</b>	<b>\$ 2,966</b>

**NOTE 7: CREDIT FACILITIES**

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to \$10.0 million that matures on June 2, 2011. As of April 1, 2011, other than standby letters of credit and guarantees (Note 14), there were no amounts outstanding under the line of credit facility and there were no borrowings in 2009 or 2010. This facility, which was amended and restated in March 2010, contains a financial covenant with the requirement for Harmonic to maintain unrestricted cash, cash equivalents and short-term investments, net of credit extensions, of not less than \$35.0 million. If Harmonic were unable to maintain this cash, cash equivalents and short-term investments balance, Harmonic would not be in compliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise

its remedies under the facility, including declaring all obligations immediately due and payable. At April 1, 2011, Harmonic was in compliance with the covenants under this line of credit facility. Future borrowings pursuant to the line would bear interest at the bank's prime rate (4.0% at April 1, 2011). Borrowings are payable monthly and are not collateralized.

**Table of Contents****NOTE 8: FINANCING LIABILITY FOR CONSTRUCTION IN PROGRESS**

The lease for the buildings at the Company's Sunnyvale, California location ended in September 2010. In December 2009, the Company entered into a lease for a building in San Jose, California, which was intended to become the Company's new headquarters. In January 2010, the Company began a build-out of this facility and during the construction incurred approximately \$18.9 million in structural leasehold improvements. Under the terms of the lease, the landlord reimbursed \$18.8 million of the construction costs. Because certain improvements constructed by the Company were considered structural in nature and the Company was responsible for any cost overruns, the Company was considered to be the owner of the construction project for accounting purposes under applicable accounting guidance on the effect of lessee involvement in asset construction.

As a result, in December 2009 the Company capitalized the fair value of the building of \$6.9 million with a corresponding credit to financing liability. The fair value was determined as of December 31, 2009, using a combination of the revenue comparison approach and the income capitalization approach. During the year ended December 31, 2010, the liability increased by \$18.9 million due to additional structural leasehold improvements, by \$0.2 million due to land lease expense and by \$0.2 million due to capitalized interest expense.

Construction was completed in September 2010, at which time the Company relocated to the new building. Upon completion of construction in September 2010, the Company concluded that it qualified for sale-leaseback accounting under applicable accounting guidance because the Company has no form of continuing involvement other than under its lease. Accordingly, the Company removed from its books the carrying value of the building, the structural leasehold improvements and the financing liability.

**NOTE 9: BENEFIT PLANS**

*Stock Plans.* As of April 1, 2011, an aggregate balance of 20,230,000 shares of common stock are reserved for issuance under various employee stock plans. Stock options are granted for periods not exceeding ten years and generally vest 25% at one year from date of grant and an additional 1/48 per month thereafter. Stock option grants have a maximum term of seven years, and are granted with exercise prices equal to the fair market value of the common stock at the date of grant. Restricted stock units ( RSUs ) have no exercise price and generally vest over four years, with 25% vesting at one year from date of grant or the vesting commencement date chosen for the award and either an additional 1/16 per quarter or 1/8 semiannually thereafter. In May 2010, Harmonic stockholders approved amendments to the 1995 Stock Plan (the 1995 Plan ) that increased the maximum number of shares of common stock authorized for issuance by an additional 10,600,000 shares, decreased the maximum term of stock options to seven years and changed the share counting provisions to provide that each award with an exercise price below 100% of the fair market value on the grant date (or no exercise price) would decrease the 1995 Plan reserve 1.5 shares for every unit or share granted and any forfeitures of these awards due to their not vesting would increase the 1995 Plan reserve by 1.5 shares for every unit or share forfeited. Previously, RSUs granted reduced the number of shares reserved for grant under the plans by two shares for every unit granted. In the three months ended April 1, 2011 and April 2, 2010, employees received RSUs valued at \$14.0 million and \$8.7 million, respectively. Certain stock option and RSU awards provide for accelerated vesting if there is a change in control and a subsequent involuntary termination of the award holder.

Upon acquisition of Omneon in September 2010, the Company assumed substantially all unvested stock options and RSUs outstanding, as of the date of closing, under Omneon's 1998 Stock Option Plan and 2008 Equity Incentive Plan, resulting in the assumption of stock options to purchase approximately 1,522,000 shares of Harmonic common stock and the assumption of RSUs for 1,455,000 shares of Harmonic common stock. The exchange of stock-based compensation awards was treated as a modification under current accounting guidance. The calculation of the fair value of the exchanged awards immediately before and after the modification did not result in any significant incremental fair value. The fair value of Harmonic's stock options and RSUs issued to Omneon employees was \$17.3 million, which was determined using the Black-Scholes option pricing model, of which \$2.1 million represents purchase consideration and \$15.2 million will be recorded as compensation expense over the weighted average service period of 2.5 years from the September 15, 2010 closing date.

*Director Option Plans.* In May 2002, Harmonic's stockholders approved the 2002 Director Option Plan (the Director Plan ), replacing the 1995 Director Option Plan. The Director Plan provides for the grant of non-statutory stock options

or RSUs to certain non-employee directors of Harmonic. In May 2010, Harmonic stockholders approved amendments to the Director Plan, increasing the maximum number of shares of common stock authorized for issuance by an additional 400,000 shares and changing the share counting provisions to provide that each award of RSUs would decrease the Director Plan reserve 1.5 shares for every unit granted and any forfeitures of unvested RSUs would increase the Director Plan reserve by 1.5 shares for every unit forfeited. Previously, RSUs

**Table of Contents**

granted reduced the number of shares reserved for grant under the Director Plan by two shares for every unit granted. As of April 1, 2011, an aggregate balance of 627,000 shares of common stock are reserved for issuance under the Director Plan. RSUs have no exercise price and vest either after one year from the grant date or on the vesting date chosen for such award. Stock options are granted at the fair market value of the common stock on the date of grant for periods not exceeding seven years. Initial option grants generally vest monthly over three years, and subsequent grants generally vest monthly over one year. In the three months ended April 1, 2011, there were 75,845 RSUs granted to non-employee directors with a grant date fair value of \$0.7 million. In the three months ended April 2, 2010, there were no RSUs granted to non-employee directors.

A summary of share-based award activity during the three months ended April 1, 2011 is as follows (in thousands):

	<b>Shares Available for Grant (In thousands)</b>
Balance at December 31, 2010	10,449
Options granted	(831)
Restricted stock units granted	(2,298)
Options cancelled	164
Restricted stock units cancelled	400
Options expired	40
Balance at April 1, 2011	7,924

The following table summarizes restricted stock unit activity under the Plans:

	<b>RSU s Outstanding</b>	<b>Weighted Average Fair Value Per Share</b>	<b>Aggregate Fair Value<sup>(1)</sup></b>
	(In thousands, except per share data)		
Balance at December 31, 2010	4,507	\$ 6.43	
Restricted stock units granted	1,532	9.59	
Restricted stock units released	(696)	6.31	\$ 6,492
Restricted stock units cancelled	(604)	6.69	
Balance at April 1, 2011	4,739	\$ 7.43	

(1) Represents the fair value of Harmonic common stock on the date that the restricted stock units vested. On the grant date, the fair value for these awards was \$4.4 million.

The following table summarizes stock option activity under the Plans:

**Table of Contents**

	<b>Stock Options Outstanding</b> (In thousands, except per option data)	<b>Average Exercise Price Per Option</b>
Balance at December 31, 2010	11,020	\$ 6.90
Options granted	831	9.63
Options exercised	(1,398)	6.58
Options cancelled	(207)	7.74
Options expired	(384)	9.11
Balance at April 1, 2011	9,862	\$ 7.07
Options vested and exercisable at April 1, 2011	6,615	
Options vested and expected-to-vest at April 1, 2011	9,700	

The weighted-average fair value of options granted for the three months ended April 1, 2011 and April 2, 2010 was \$4.55 and \$3.18, respectively.

The following table summarizes information regarding stock options outstanding at April 1, 2011:

	<b>Stock Options Outstanding</b>			<b>Stock Options Exercisable</b>	
	<b>Number Outstanding at April 1, 2011</b>	<b>Weighted Average Remaining Contractual Life (In Years)</b>	<b>Weighted Average Exercise Price Per Option</b>	<b>Number Exercisable at April 1, 2011</b>	<b>Weighted Average Exercise Price Per Option</b>
<b>Range of Exercise Prices</b>					
\$ 0.19 - 4.13	1,425	6.7	\$ 2.42	649	\$ 2.62
4.16 - 5.87	1,882	3.5	5.69	1,396	5.70
5.88 - 8.12	1,045	5.1	6.64	464	6.72
8.17 - 8.17	1,928	4.0	8.17	1,414	8.17
8.20 - 8.84	1,418	3.2	8.28	1,324	8.25
8.87 - 9.69	1,523	4.6	9.41	742	9.11
9.74 - 16.73	641	1.5	10.63	626	10.64
	9,862	4.2	\$ 7.07	6,615	\$ 7.36

The weighted-average remaining contractual life for all exercisable stock options at April 1, 2011 was 3.2 years. The weighted-average remaining contractual life of all vested and expected-to-vest stock options at April 1, 2011 was 4.2 years. The weighted-average remaining contractual life of all vested and expected-to-vest restricted stock units at April 1, 2011 was 1.6 years.

Aggregate intrinsic value of options exercisable at April 1, 2011 was \$13.2 million. The aggregate intrinsic value of stock options vested and expected-to-vest, net of estimated forfeitures, was \$22.1 million at April 1, 2011. Aggregate intrinsic value represents the difference between our closing price on the last trading day of the fiscal period, which was \$9.22 as of April 1, 2011, and the exercise price multiplied by the number of options outstanding or exercisable. The intrinsic value of exercised stock options is calculated based on the difference between the exercise price and the market value of the common stock at the time of exercise. The aggregate intrinsic value of exercised stock options was \$4.1 million during the three months ended April 1, 2011.

*Employee Stock Purchase Plan.* In May 2002, Harmonic's stockholders approved the 2002 Employee Stock Purchase Plan (the 2002 Purchase Plan) replacing the 1995 Employee Stock Purchase Plan effective for the offering period beginning on July 1, 2002. As a result of the adoption of the 2002 Purchase Plan and subsequent stockholder-approved amendments, a total of 7.5 million shares have been approved for issuance pursuant to the 2002 Purchase Plan. The 2002 Purchase Plan enables employees to purchase shares at 85% of the fair market value of the common stock at the beginning or end of each six month offering period, whichever is lower. Offering periods generally begin on the first trading day on or after January 1 and July 1 of each year. The 2002 Purchase Plan is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. During the three months ended April 1, 2011 and April 2, 2010, the number of shares of stock issued under the purchase plans was 468,660 and 420,066, at weighted average prices of \$4.73 and \$5.07, respectively. The weighted-average fair value of each right to purchase shares of common stock

**Table of Contents**

granted under the 2002 Purchase Plan during the three months ended April 1, 2011 and April 2, 2010 was \$2.58 and \$1.91, respectively. At April 1, 2011, a total of 1,306,413 shares were reserved for future issuances under the 2002 Purchase Plan.

*Retirement/Savings Plan.* Harmonic has a retirement/savings plan that qualifies as a thrift plan under Section 401(k) of the Internal Revenue Code. This plan allows participants to contribute up to 20% of total compensation, subject to applicable Internal Revenue Service limitations. Harmonic can make discretionary contributions to the plan of 25% of the first 4% contributed by eligible participants, up to a maximum contribution per participant of \$1,000 per year. The employer contribution was suspended during the first quarter of 2009.

*Stock-based Compensation*

The following table summarizes stock-based compensation costs in our Condensed Consolidated Statements of Operations for the three months ended April 1, 2011 and April 2, 2010:

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands)	
<b>Employee stock-based compensation in:</b>		
Cost of revenue	\$ 747	\$ 478
Research and development expense	1,836	1,109
Selling, general and administrative expense	3,419	1,656
Total employee stock-based compensation in operating expense	5,255	2,765
Total employee stock-based compensation	6,002	3,243
Amount capitalized in inventory	14	31
Total stock-based compensation	\$ 6,016	\$ 3,274

As of April 1, 2011, total unamortized stock-based compensation cost related to unvested stock options and restricted stock units was \$46.3 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.8 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes single option pricing model with the following weighted average assumptions:

	<b>Employee Stock Options</b>		<b>Employee Stock Purchase Plan</b>	
	<b>Three months ended</b>		<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>	<b>April 1, 2011</b>	<b>April 2, 2010</b>
Expected life (in years)	4.75	4.75	0.5	0.5
Volatility	54%	57%	54%	50%
Risk-free interest rate	2.1%	2.5%	0.3%	0.4%
Dividend yield	0.0%	0.0%	0.0%	0.0%

The expected life for stock options under the 2002 Purchase Plan represents the weighted-average period that the stock options are expected to remain outstanding. Our computation of expected life was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior.



We use the historical volatility over the expected term of the options and the 2002 Purchase Plan offering period to estimate the expected volatility.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our employee stock options and employee stock purchase plan awards. The dividend yield assumption is based on our history and expectation of dividend payouts.

**Table of Contents****NOTE 10: INCOME TAXES**

The income tax provision includes U.S. federal, state and local, and foreign income taxes and is based on the application of a forecasted annual income tax rate applied to the current quarter's year-to-date pre-tax income (loss). In determining the estimated annual effective income tax rate, the Company analyzes various factors, including projections of the Company's annual earnings, taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, the Company's ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than being included in the estimated annual effective income tax rate.

For the three months ended April 1, 2011, the Company recorded a benefit from income taxes of \$0.6 million, compared to a benefit from income taxes of \$2.8 million for the same period a year ago, inclusive of discrete items. For the three months ended April 1, 2011, the difference between the recorded benefit from income taxes and the tax provision based on the federal statutory rate of 35% was primarily attributable to various discrete items, the differential in foreign tax rates, non-deductible stock-based compensation expense, non-deductible amortization on foreign intangibles, and federal research and development credits. The discrete items recorded in the first quarter of 2011 principally related to foreign currency translation adjustments, accrued interest on uncertain tax positions and a benefit associated with the reversal of previously provided foreign income taxes due to statute of limitation expirations.

For the three months ended April 2, 2010, the difference between the the recorded benefit from income taxes and the tax provision based on the federal statutory rate of 35% was primarily attributable to various discrete items, the differential in foreign tax rates, non-deductible stock-based compensation expense, and California research and development credits. The discrete items recorded in the first quarter of 2010 principally related to a benefit associated with the reversal of previously provided foreign income taxes due to expiration of the statute of limitations and, to a lesser extent, a benefit associated with the release of a portion of the valuation allowance on certain California deferred tax assets. The release of the valuation allowance on the California deferred tax assets was due to an increase in the estimated amount of income that would be apportioned to California, based on anticipated changes in the geographic mix of sales.

In compliance with applicable guidance for accounting for uncertainty in income taxes, the Company had gross unrecognized tax benefits, which include interest and penalties, of approximately \$53.5 million as of December 31, 2010, and approximately \$53.3 million as of April 1, 2011. If all of these unrecognized tax benefits were recognized, the entire amount would impact the provision for income taxes. We anticipate the unrecognized tax benefits to decrease by \$3.2 million in the next 12 months due to statute of limitation expirations.

We recognize interest and penalties related to uncertain tax positions in income tax expense. During the quarter ended April 1, 2011, we recorded an insignificant net reduction for interest and penalties related to uncertain tax positions, resulting in a balance at April 1, 2011 of \$5.0 million.

The tax years 2003-2010 remain open to examination by various federal, state or foreign taxing jurisdictions.

The Company's income tax returns for 2008 and 2009 are currently under examination by the U.S. Internal Revenue Service.

**Table of Contents****NOTE 11: NET INCOME PER SHARE**

Basic net income per share is computed by dividing net income for the period by the weighted average number of the common shares outstanding during the period.

The following table shows the potentially dilutive shares, consisting of options, restricted stock units and ESPP shares, for the periods presented that were excluded from the net income computations because their effect was antidilutive:

	<b>Three months ended</b>	
	<b>April</b>	
	<b>1,</b>	
	<b>2011</b>	<b>April 2, 2010</b>
	(In thousands)	
Potentially dilutive equity awards outstanding	7,990	11,729

Following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations:

	<b>Three months ended</b>	
	<b>April 1,</b>	
	<b>2011</b>	
	<b>April 2, 2010</b>	
	(In thousands, except per share amounts)	
Net income (numerator)	\$ 516	\$ 5,319
Shares calculation (denominator):		
Weighted average shares outstanding basic	113,836	96,684
Effect of Dilutive Securities:		
Potential common stock relating to stock options, restricted stock units and ESPP	2,273	660
Weighted averages shares outstanding diluted	116,109	97,344
Net income per share basic	\$ 0.00	\$ 0.06
Net income per share diluted	\$ 0.00	\$ 0.05

**NOTE 12: COMPREHENSIVE INCOME**

The Company's total comprehensive income was as follows:

	<b>Three months ended</b>	
	<b>April</b>	
	<b>1,</b>	
	<b>2011</b>	<b>April 2, 2010</b>
	(In thousands)	
Net income	\$ 516	\$ 5,319
Change in unrealized loss on investments, net	(11)	(216)
Foreign currency translation	454	(138)
Total comprehensive income	\$ 959	\$ 4,965

**NOTE 13: SEGMENT INFORMATION**

The Company operates its business in one reportable segment, which is the design, manufacture and sale of video infrastructure solutions, spanning content production to multi-screen video delivery. Harmonic's products enable customers to create, prepare and deliver video services over broadcast, cable, Internet, mobile, satellite and networks. Operating segments are defined as components of an enterprise that engage in business activities for which separate financial information is available and evaluated by the chief operating decision maker in deciding how to allocate resources and assessing performance. Our chief operating decision maker is our Chief Executive Officer. The acquisition of Omneon in September 2010 resulted in an additional product line, production and playout, but did not impact our reportable segments.

**Table of Contents**

The Company's revenue by product type is summarized as follows:

	<b>Three months ended</b>	
	<b>April 1,</b>	<b>April 2, 2010</b>
	<b>2011</b>	
	(In thousands)	
Video processing products	\$ 63,758	\$ 38,890
Production and playout products	20,933	
Edge and access products	31,176	35,544
Service and support	16,968	10,388
	<b>\$ 132,835</b>	<b>\$ 84,822</b>

Our revenue by geographic region, based on the location of our customer, and our property and equipment, net by geographic region, is summarized as follows:

	<b>Three months ended</b>	
	<b>April 1,</b>	<b>April 2, 2010</b>
	<b>2011</b>	
	(In thousands)	
<b>Net revenue:</b>		
United States	\$ 58,954	\$ 42,592
International	73,881	42,230
	<b>\$ 132,835</b>	<b>\$ 84,822</b>

	<b>April 1,</b>	<b>December 31,</b>
	<b>2011</b>	<b>2010</b>
	(In thousands)	
<b>Property and equipment, net:</b>		
United States	\$ 31,899	\$ 32,104
International	7,698	7,721
	<b>\$ 39,597</b>	<b>\$ 39,825</b>

*Major Customers.* For the three months ended April 1, 2011 and April 2, 2010, revenue to Comcast accounted for 11% and 14% of net revenue, respectively. As of April 1, 2011, Comcast accounted for 16% of net accounts receivable.

**NOTE 14: GUARANTEES**

*Warranties.* The Company accrues for estimated warranty costs at the time of product shipment. Management periodically reviews the estimated fair value of its warranty liability and records adjustments based on the terms of warranties provided to customers, historical and anticipated warranty claims experience, and estimates of the timing and cost of specified warranty claims. Activity for the Company's warranty accrual, which is included in accrued liabilities, is summarized below:

	<b>Three months ended</b>	
	<b>April</b>	<b>April 2, 2010</b>
	<b>1, 2011</b>	

	(In thousands)	
Balance at beginning of period	\$ 4,811	\$ 4,186
Accrual for current period warranties	2,262	451
Warranty costs incurred	(1,810)	(1,211)
Balance at end of period	\$ 5,263	\$ 3,426

*Standby Letters of Credit.* As of April 1, 2011, the Company's financial guarantees consisted of standby letters of credit outstanding, which were principally related to performance bonds and state requirements imposed on employers. The maximum amount of potential future payments under these arrangements was \$1.0 million.

*Indemnification.* Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and customers for specified intellectual property

**Table of Contents**

matters pursuant to certain contractual arrangements, subject to certain limitations. The scope of these indemnities varies, but in some instances, includes indemnification for damages and expenses (including reasonable attorneys fees). There have been no amounts accrued in respect of the indemnification provisions through April 1, 2011.

*Guarantees.* As of April 1, 2011, Harmonic had no other guarantees outstanding.

**NOTE 15: LEGAL PROCEEDINGS**

In March 2010, Interkey ELC Ltd, or Interkey, filed a lawsuit in Israel alleging breach of contract against Harmonic and Scopus Video Networks Ltd. (now Harmonic Video Networks Ltd. or HVN ), which was acquired by Harmonic in March 2009. The plaintiffs are seeking damages in the amount of 6,300,000 ILS (approximately \$1.7 million).

Although, as is the case with all litigation, no assurances can be given as to the outcome of the Interkey lawsuit, Harmonic believes Interkey's and its shareholders' claims are without merit and Harmonic and HVN intend to vigorously defend themselves against these claims. Based on the foregoing, Harmonic has not recorded a provision for this claim.

In April 2010, Arris Corporation filed a complaint in United States District Court in Atlanta, alleging that our Streamliner 3000 product infringes four patents held by Arris. The complaint sought injunctive relief and damages. In connection with this matter, we recorded a \$1.3 million liability in the fourth quarter of 2010, based on a tentative agreement of Arris and Harmonic with respect to settlement of the action. In April 2011, this matter was settled on essentially the same terms as the tentative agreement, the Company paid Arris \$1.3 million, and the action was dismissed.

An unfavorable outcome on the above referenced or any other litigation matters could require that Harmonic pay substantial damages, or, in connection with any intellectual property infringement claims, could require that the Company pay ongoing royalty payments or could prevent the Company from selling certain of its products. As a result, a settlement of, or an unfavorable outcome on, any of the above referenced or other litigation matters could have a material adverse effect on Harmonic's business, operating results, financial position and cash flows.

Harmonic's industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. From time to time, third parties have asserted, and may in the future assert, exclusive patent, copyright, trademark and other intellectual property rights against us or the Company's customers. Such assertions arise in the normal course of the Company's operations. The resolution of any such assertions and claims cannot be predicted with certainty.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The terms Harmonic, the Company, we, us, its, and our, as used in this Quarterly Report on Form 10-Q, refer to Harmonic Inc. and its subsidiaries and its predecessors as a combined entity, except where the context requires otherwise.

Some of the statements contained in this Quarterly Report on Form 10-Q are forward-looking statements that involve risk and uncertainties. The statements contained in this Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, without limitation, statements regarding our expectations, beliefs, intentions or strategies regarding the future. In some cases, you can identify forward-looking statements by terminology such as, may, will, should, expects, plans, anticipates, believes, intends, estimates, will continue or the negative of these terms or other comparable terminology. These forward-looking statements include, but are not limited to, statements regarding:

- developing trends in the broadcasting and television business;

- continuation of customer concentration;

- capital spending of our customers in 2011;

- our strategic direction, future business plans and growth strategy;

increases in our international revenue;

industry and customer consolidation;

anticipated changes in economic conditions or the financial markets, and the potential impact on our business;



**Table of Contents**

the expected demand for, and benefits of, our products and services;

seasonality of revenue and concentration of revenue sources;

anticipated benefits of recent acquisitions;

potential future acquisitions;

statements regarding anticipated results of potential or actual litigation;

our competitive environment;

the impact of governmental regulation;

the impact of uncertain economic times and markets;

anticipated revenue and expenses, including the sources of such revenue and expenses;

expected impacts of changes in accounting rules;

use of cash, cash needs and ability to raise capital; and

the condition of our cash investments.

These statements are subject to known and unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward-looking statements. Important factors that may cause actual results to differ from expectations include those discussed in Risk Factors beginning on page 32 of this Form 10-Q. All forward-looking statements included in this Form 10-Q are based on information available to us on the date thereof, and we assume no obligation to update any such forward-looking statements.

**Overview**

Harmonic designs, manufactures and sells versatile and high performance video infrastructure products and system solutions that enable our customers to efficiently create, prepare and deliver broadcast and on-demand video services to televisions, personal computers and mobile devices. Historically, the majority of our sales have been derived from sales of video processing solutions and network edge and access systems to cable television operators and from sales of video processing solutions to direct-to-home satellite operators. More recently, we are providing our video processing solutions to telecommunications companies, or telcos, broadcasters and other media companies that create video programming or offer video services. In September 2010, we acquired Omneon, Inc., a private, venture-backed company specializing in file-based infrastructure for the production, preparation and playout of video content typically deployed by broadcasters, satellite operators, content owners and other media companies. The acquisition of Omneon, which is further described below, is complementary to Harmonic's core business, expanding our customer reach into content providers and extending our product lines into video servers and video-optimized storage for content production and playout.

Harmonic's revenue increased by 57% in the first quarter of 2011 compared to the same period in 2010. The increase in revenue in 2011 was due, in part, to stronger worldwide customer demand for video processing solutions. In addition, Harmonic's revenue also increased as a result of the acquisition of Omneon in September 2010. Omneon's product revenue, which for the first quarter of 2011 was \$20.9 million, is included in the production and playout product line under Net Revenue Consolidated below. The growth in video processing revenue of 64% and the addition of Omneon also contributed to the growth in service and support activity related to the associated product solutions, resulting in services and support revenue growth of 63% in the first quarter of 2011, when compared to the same period in 2010.

Financial difficulties of certain of our customers and changes in our customers' deployment plans have adversely affected our business in the past. In 2008 and 2009, economic conditions in many of the countries in which we sell products were very weak, and global

**Table of Contents**

economic conditions and financial markets experienced a severe downturn. The downturn stemmed from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns.

Although there was an increase in global economic activity in 2010, economic growth may remain sluggish during 2011 in a few developed countries and in some emerging market countries. The severity or length of time that these adverse economic and financial market conditions may persist, or whether such adverse conditions may return in the U.S. and in other countries, is unknown. During challenging or uncertain economic times, and in tight credit markets, many customers may delay or reduce capital expenditures, which in turn often results in lower demand for our products.

Sales to customers outside of the U.S. in the first quarter of 2011 and 2010 represented 56%, and 50% of net revenue, respectively. A significant portion of international sales are made to distributors and system integrators, which are generally responsible for importing the products and providing installation and technical support and service to customers within their territory. We expect international sales to continue to account for a substantial portion of our net revenue for the foreseeable future, and expect that, partially as a result of the acquisitions of Scopus in 2009 and of Omneon in 2010, our international sales may continue to increase.

Further, we have a number of international customers to whom sales are denominated in U.S. dollars. Sales denominated in foreign currencies were approximately 9% and 7% of net revenue in the first quarter of 2011 and 2010, respectively. The value of the U.S. dollar fluctuates significantly against many foreign currencies, which includes the local currencies of many of our international customers. If the U.S. dollar appreciates relative to the local currencies of our customers, then the prices of our products correspondingly increase for such customers. Such an effect could adversely impact sales of our products to such customers and result in longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition in the affected countries. Further, if the U.S. dollar were to weaken against many major currencies, there can be no assurance that a weaker dollar would lead to growth in capital spending.

In addition, industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. Also, if our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of customers in the markets on which we focus, our revenue may decline. Historically, a majority of our revenue has been derived from relatively few customers, due in part to the consolidation of the ownership of cable television and direct broadcast satellite system companies. However, in the last two years, revenue from our ten largest customers has decreased as a percentage of revenue, due to our growing customer base, in part as a result of the acquisitions of Scopus and Omneon. Sales to our ten largest customers in the first quarter of 2011 and 2010 accounted for approximately 35% and 51% of revenue, respectively. Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration.

In the first quarter of 2011 and 2010, sales to Comcast accounted for 11% and 14% of net revenue, respectively. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, including, from time to time, projects in which we act much like a systems integrator. A decrease in the number of the relatively larger individual transactions in which we are involved in any quarter could adversely affect our operating results for that quarter.

In addition, historically, we have been dependent upon capital spending in the cable and satellite industries. We are attempting to further diversify our customer base beyond cable and satellite customers, including to the telco and broadcast and media markets. Several major telcos have rebuilt or are upgrading their networks to offer bundled video, voice and data services. In order to be successful in this market, we may need to continue to build alliances with telco equipment manufacturers, adapt our products for telco applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the telco industry. In addition, telco video deployments, including recent trials of mobile video services, are subject to delays in

completion, as video processing technologies and video business models are relatively new to most telcos and many of their largest suppliers. Implementation issues with our products or those of other vendors have caused, and may continue to cause, delays in project completion for our customers and delay our recognition of revenue.

**Table of Contents**

We often recognize a substantial portion of our quarterly revenues in the last month of the quarter. We establish our expenditure levels for product development and other operating expenses based on projected revenue levels for a specified period, and expenses are relatively fixed in the short term. Accordingly, even small variations in timing of revenue, particularly from large individual transactions, can cause significant fluctuations in operating results in a particular quarter.

On September 15, 2010, Harmonic completed the acquisition of Omneon, Inc., a private, venture-backed company organized under the laws of Delaware and headquartered in Sunnyvale, California. The purchase price, net of \$40.5 million of cash acquired, was \$251.3 million, which consisted of (i) approximately \$153.3 million in cash, net of cash acquired, (ii) 14.2 million shares of Harmonic common stock with a total fair value of approximately \$95.9 million, based on the price of Harmonic common stock at the time of close, and (iii) approximately \$2.1 million, representing the fair value attributed to shares of Omneon equity awards which Harmonic assumed and for which services had already been rendered as of the close of the acquisition. The cash portion of the purchase price was paid from existing cash balances. The Company also incurred a total of \$5.9 million of transaction expenses, which were expensed as selling, general and administrative expenses in the year ended December 31, 2010. Substantially all unvested stock options and unvested restricted stock units issued by Omneon and outstanding at closing were assumed by Harmonic.

We continue to expand our international operations and staffing to better support our expansion into international markets. This expansion includes the implementation of an international structure that includes, among other things, an international support center in Europe, a research and development cost-sharing arrangement, and certain licenses and other contractual arrangements by and among the Company and its wholly-owned domestic and foreign subsidiaries. Our foreign subsidiaries have acquired certain license rights to use our existing intellectual property and intellectual property that will be developed or licensed in the future, including Omneon's existing and future intellectual property. As a result of these changes and an expanding customer base internationally, we expect that an increasing percentage of our consolidated pre-tax income will be derived from, and reinvested in, our international operations. We anticipate that this pre-tax income will be subject to foreign tax at relatively lower tax rates when compared to the United States federal statutory tax rate in future periods.

**Critical Accounting Policies, Judgments and Estimates**

The preparation of financial statements and related disclosures requires Harmonic to make judgments, assumptions and estimates that affect the reported amounts of assets and liabilities, the disclosure of contingencies, and the reported amounts of revenue and expenses in the financial statements and accompanying notes. Material differences may result in the amount and timing of revenue and expenses if different judgments or different estimates were made. Our significant accounting policies are described in Note 1 to the annual Consolidated Financial Statements as of and for the year ended December 31, 2010, included in our 2010 Form 10-K and the notes to the Condensed Consolidated Financial Statements as of and for the three months ended April 1, 2011, included in this Form 10-Q. Critical accounting policies, judgments and estimates which we believe have the most significant impact on Harmonic's financial statements have not changed since December 31, 2010, except as described in Note 1 to the Condensed Consolidated Financial Statements included herein, and are set forth below:

Revenue recognition;

Allowances for doubtful accounts, returns and discounts;

Valuation of inventories;

Impairment of goodwill or long-lived assets;

Restructuring costs and accruals for excess facilities;

Assessment of the probability of the outcome of litigation;

Accounting for income taxes, and

Stock-based compensation.

**Table of Contents****Results of Operations**

Harmonic's condensed consolidated statements of operations data for the first quarter of 2011 and 2010, as a percentage of net revenue, is as follows:

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
Net revenue	100%	100%
Cost of revenue	53	52
Gross profit	47	48
Operating expenses:		
Research and development	20	20
Selling, general and administrative	25	24
Amortization of intangibles	2	1
Total operating expenses	47	45
Income (loss) from operations	(0)	3
Interest and other income, net	(0)	0
Income (loss) before income taxes	(0)	3
Benefit from income taxes	(0)	(3)
Net income	0%	6%

*Net Revenue Consolidated*

Harmonic's consolidated net revenue in the first quarter of 2011, compared with the corresponding period in 2010, is presented in the table below. Also presented are the related dollar and percentage changes in consolidated net revenue in the first quarter of 2011, compared with the corresponding period in 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
<b>Revenue by type:</b>		
Video processing products	\$ 63,758	\$ 38,890
Production and playout products	20,933	
Edge and access products	31,176	35,544
Service and support	16,968	10,388
Net revenue	\$ 132,835	\$ 84,822
<b>Increase (decrease):</b>		
Video processing products	\$ 24,868	
Production and playout products	20,933	
Edge and access products	(4,368)	

Service and support	6,580
Total increase	\$ 48,013

**Percent change:**

Video processing products	64%
Production and playout products	
Edge and access products	(12)
Service and support	63
Total percent change	57%

The increase in net revenue in the first quarter of 2011, compared to the same period of 2010, was in part due to stronger worldwide demand for video processing solutions. In addition, our revenue increased as a result of the acquisition of Omneon. Omneon's



**Table of Contents**

product revenue is included in the production and playout product line above. The growth in video processing products revenue of 64% and the addition of Omneon also contributed to the growth in service and support activity related to the associated products, resulting in service and support revenue growth of 63% in 2011, when compared to the same period in 2010. The decrease in sales of edge and access products in the first quarter of 2011, compared to the same period in 2010, was primarily due to a decrease in sales of edge products, which are used for VOD, M-CMTS and switched digital video applications to domestic and international cable operators.

*Net Revenue - Geographic*

Harmonic's domestic and international net revenue in the first quarter of 2011, compared with the corresponding period in 2010, is presented in the table below. Also presented are the related dollar and percentage change in domestic and international net revenue in the first quarter of 2011, compared with the corresponding period in 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
<b>Net revenue:</b>		
United States	\$ 58,954	\$ 42,592
International	73,881	42,230
 Total	 \$ 132,835	 \$ 84,822
 <b>Increase:</b>		
United States	\$ 16,362	
International	31,651	
 Total increase	 \$ 48,013	
 <b>Percent change:</b>		
United States		38%
International		75
Total percent change		57%

The increase in U.S. net revenue in the first quarter of 2011, compared to the corresponding period in 2010, was principally due to increased demand from our domestic cable and satellite customers for HD video encoding solutions and increased service and support revenue.

International net revenue in the first quarter of 2011 increased, compared to the corresponding period in 2010, primarily due to increased demand from customers in emerging markets, such as Latin America, and sales of Omneon production and playout products, given that a substantial majority of production and playout net revenues were international. We expect that international sales will continue to account for a significant portion of our net revenue for the foreseeable future, and expect that, with the completion of the acquisition of Omneon in particular, our international revenue may increase.

*Gross Profit*

Harmonic's gross profit and gross profit as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in gross profit in the first quarter of 2011, as compared with the corresponding period in 2010.

**Three months ended**

	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Gross profit	\$ 61,855	\$ 40,806
As a percentage of net revenue	47%	48%
Increase	\$ 21,049	
Percent change	52%	

**Table of Contents**

The increase in gross profit in the first quarter of 2011, as compared to the corresponding period in 2010, was primarily due to increased net revenue in 2011. The gross profit percentage of 47% in the first quarter of 2011, compared to 48% in the first quarter of 2010, was lower mainly due to higher amortization of intangibles.

In the first quarter of 2011, \$5.1 million of amortization of intangibles was included in cost of sales compared to \$2.1 million in the first quarter of 2010. The higher amortization of intangible expense in the first quarter of 2011 was due to the amortization of intangibles arising from the Omneon acquisition, which was completed in September 2010. We expect to record approximately \$16.4 million in amortization of intangibles expenses in cost of sales in the remaining nine months of 2011, primarily related to intangible assets acquired in connection with the acquisitions of Scopus and Omneon.

*Research and Development*

Harmonic's research and development expense and the expense as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in research and development expense in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Research and development	\$ 26,149	\$ 16,966
As a percentage of net revenue	20%	20%
Increase	\$ 9,183	
Percent change	54%	

The increase in research and development expense in the first quarter of 2011, compared to the corresponding period in 2010, was primarily the result of increased compensation expense of \$4.9 million, increased facilities related expenses of \$1.7 million, increased outside engineering services of \$1.6 million and increased stock-based compensation expense of \$0.7 million. The increased compensation expense and outside engineering services were primarily due to increased engineering headcount and activities related to the Omneon acquisition, as well as additional hiring of employees engaged in engineering activities. The increased facilities related expenses were primarily due to additional depreciation of building improvements and lab equipment costs related to the Omneon acquisition.

*Selling, General and Administrative*

Harmonic's selling, general and administrative expense and the expense as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in selling, general and administrative expense in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Selling, general and administrative	\$ 33,564	\$ 20,845
As a percentage of net revenue	25%	25%
Increase	\$ 12,719	
Percent change	61%	

The increase in selling, general and administrative expense in the first quarter of 2011, compared to the corresponding period in 2010, was primarily a result of increased compensation expense of \$6.0 million, increased stock-based compensation expense of \$1.8 million, increased marketing and selling expense of \$1.3 million, increased facilities related expenses of \$1.2 million, increased consulting and professional service expense of \$0.9 million and increased

travel expense of \$0.9 million. The increased compensation expense, stock-based compensation expense, marketing and selling expense and travel expense is primarily due to increased headcount related to the Omneon acquisition and higher commission expense resulting from increased net revenue in 2011. The increase in consulting and professional service expense is related to higher temporary headcount and additional consulting resources being used in general and administrative activities. The

**Table of Contents**

increased facilities related expense was partially due to the additional \$0.5 million of excess facilities reserve recorded in the first quarter of 2011 related to Omneon's headquarters in Sunnyvale, California.

*Amortization of Intangibles*

Harmonic's amortization of intangible assets and the expense as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in amortization of intangible assets in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Amortization of intangibles	\$ 2,229	\$ 534
As a percentage of net revenue	2%	1%
Increase	\$ 1,695	
Percent change	317%	

The increase in the amortization of intangibles expense in the first quarter of 2011, compared to the corresponding period in 2010, was primarily due to the amortization of intangible assets obtained in connection with the acquisition of Omneon during the third quarter of 2010. Harmonic expects to record a total of approximately \$6.7 million in amortization of intangibles expense in operating expenses in the remaining nine months of 2011, primarily resulting from the acquisitions of Scopus and Omneon.

*Interest Income, Net*

Harmonic's interest income, net, and interest income, net, as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in interest income, net, in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Interest income, net	\$ 92	\$ 384
As a percentage of net revenue	0%	0%
Decrease	\$ (292)	
Percent change	(76)%	

The decrease in interest income, net in the first quarter of 2011, compared to the first quarter of 2010, was primarily due to a lower portfolio balance during the quarter, principally resulting from cash used in the Omneon acquisition, and lower interest rates earned on the cash and short-term investments portfolio.

*Other Expense, Net*

Harmonic's other expense, net, and other expense, net, as a percentage of consolidated net revenue in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage change in other expense, net, in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>

	(In thousands, except percentages)	
Other expense, net	\$ 107	\$ 371
As a percentage of net revenue	0%	0%
Decrease	\$ (264)	
Percent change	(71)%	

**Table of Contents**

The decrease in other expense, net, in the first quarter of 2011, compared to the corresponding period of 2010, was primarily due to lower foreign exchange losses on accounts receivable denominated in currencies other than the U.S. dollar.

*Income Taxes*

Harmonic's benefit from income taxes, and benefit from income taxes, as a percentage of consolidated net revenue, in the first quarter of 2011, as compared with the corresponding period of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in income taxes in the first quarter of 2011, as compared with the corresponding period of 2010.

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands, except percentages)	
Benefit from income taxes	\$ 618	\$ 2,845
As a percentage of net revenue	0%	3%
Decrease	\$ (2,227)	
Percent change	(78)%	

The decrease in the benefit from income taxes in the first quarter of 2011, compared to the same period in 2010, was primarily attributable to a reduced benefit as a result of the reversal of foreign taxes previously accrued as uncertain tax benefits, due to an expiration of the statute of limitations, and a reduction of a benefit recorded in the first quarter of 2010 associated with the release of a portion of the valuation allowance on certain California deferred tax assets, both of which were discrete items.

The Company's income tax returns for 2008 and 2009 are currently under examination by the U.S. Internal Revenue Service.

**Liquidity and Capital Resources**

	<b>Three months ended</b>	
	<b>April 1, 2011</b>	<b>April 2, 2010</b>
	(In thousands)	
Net cash used in operating activities	\$ (7,683)	\$ (2,979)
Net cash provided by (used in) investing activities	(38,871)	4,772
Net cash provided by financing activities	9,570	1,736

As of April 1, 2011, cash, cash equivalents and short-term investments totaled \$117.3 million, compared to \$120.4 million as of December 31, 2010. Cash used in operations in the first three months of 2011 was \$7.7 million, resulting from net income of \$0.5 million, increased by an aggregate of \$17.0 million in non-cash charges and decreased by an aggregate of \$25.2 million in net change in assets and liabilities. The non-cash charges included principally amortization of intangible assets, stock-based compensation and depreciation. The net change in assets and liabilities included: (a) increases in accounts receivable and inventories, which was partially offset by a decrease in prepaid expenses; and (b) decreases in accounts payable, income taxes payable and accrued and other liabilities, which was partially offset by an increase in deferred revenue. The increase in accounts receivable is due to the non-linearity of invoicing in the quarter. The decrease in accrued and other liabilities was principally attributable to payment of incentive compensation accruals from 2010.

Cash used in operations in the first three months of 2010 was \$3.0 million, resulting from net income of \$5.3 million, adjusted for \$7.4 million in non-cash charges and a \$15.7 million net change in assets and liabilities. The significant non-cash charges included stock-based compensation, depreciation and amortization of intangible assets. The net change in assets and liabilities included an increase in accounts receivable due to higher shipments in the first quarter of 2010 compared to the first quarter of 2009, a decrease in accrued liabilities primarily from the payment of incentive compensation, an increase in inventories primarily due to an increase in service and demo inventories, and lower

accounts payable primarily from the payment of inventory purchases, which was partially offset by an increase in deferred revenue.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including, without limitation, fluctuations in our operating results, shipment linearity, accounts receivable collections performance, inventory and supply chain management, and the timing and amount of compensation and other payments. We typically pay our annual incentive compensation to employees in the first quarter.

Net cash used in investing activities was \$38.9 million in the first quarter of 2011, resulting from the purchase of short-term investments of \$41.8 million and capital expenditures of \$5.0 million, partially offset by proceeds from the net sale and maturity of investments of \$7.9 million. Harmonic currently expects capital expenditures will be in the range of \$12 million to \$16 million during 2011.

Net cash provided by investing activities was \$4.8 million in the first quarter of 2010, resulting from proceeds from the maturity of investments of \$41.3 million, partially offset by the purchase of investments of \$35.4 million and capital expenditures of \$1.1 million.



**Table of Contents**

Net cash provided by financing activities of \$9.6 million in the first quarter of 2011 and \$1.7 million in the same period a year ago was the result of net proceeds from the issuance of common stock related to our employee stock plans.

In the event we need or desire to access funds from the other short-term investments that we hold, it is possible that we may not be able to do so due to adverse market conditions. Our inability to sell all or some of our short-term investments at par or our cost, or any rating downgrades of issuers of these securities, could adversely affect our results of operations or financial condition. Nevertheless, we believe that our existing liquidity sources will satisfy our presently contemplated cash requirements for at least the next twelve months. However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated opportunities, or to strengthen our financial position.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities, or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital or could require us to issue our stock and dilute existing stockholders. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market or acquisition opportunities, to develop new products, or to otherwise respond to competitive pressures.

Our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including the global economic slowdown, market uncertainty surrounding the ongoing U.S. war on terrorism, or conditions in financial markets and the industries we serve. There can be no assurance that any financing will be available on terms acceptable to us, or at all.

**Off-Balance Sheet Arrangements**

None as of April 1, 2011.

**Contractual Obligations and Commitments**

There were no significant changes to our contractual obligations and commitments in the first quarter of 2011, compared to the information presented in our 2010 Form 10-K.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk represents the risk of loss that may impact the operating results, financial position, or liquidity of Harmonic due to adverse changes in market prices and rates. Harmonic is exposed to market risk because of changes in interest rates, foreign currency exchange rates, as measured against the U.S. dollar and currencies of Harmonic's subsidiaries, and changes in the value of financial instruments held by Harmonic.

*Foreign Currency Exchange Risk*

Harmonic has a number of international subsidiaries, each of whose sales are generally denominated in U.S. dollars. In addition, Harmonic has various international branch offices that provide sales support and systems integration services. Sales denominated in foreign currencies were approximately 9% and 7% of net revenue in the first quarter of 2011 and 2010, respectively. Periodically, Harmonic enters into foreign currency forward exchange contracts (forward exchange contracts) to manage exposure related to foreign accounts receivable and reduce the effects of fluctuating exchange rates on expenses denominated in foreign currencies. Harmonic does not enter into derivative financial instruments for trading purposes. At April 1, 2011, we had a forward exchange contract to sell Euros totaling \$5.1 million. This forward exchange contract matured in April 2011. While Harmonic does not anticipate that near-term changes in exchange rates will have a material impact on Harmonic's operating results, financial position and liquidity, Harmonic cannot assure you that a sudden and significant change in the value of local currencies would not harm Harmonic's operating results, financial position and liquidity.

*Interest Rate Risk*

Exposure to market risk for changes in interest rates relates primarily to Harmonic's investment portfolio of marketable debt securities of various issuers, types and maturities and to Harmonic's borrowings under its bank line of credit facility. Harmonic has no

**Table of Contents**

borrowings under its bank line of credit. Harmonic does not use derivative instruments in its investment portfolio, and its investment portfolio only includes highly liquid instruments. These investments are classified as available for sale and are carried at estimated fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss). As of April 1, 2011, gross unrealized gains were nominal. If the credit market deteriorates, we may incur realized losses, which could adversely affect our financial condition or results of operations. There is risk that losses could be incurred if Harmonic were to sell any of its securities prior to stated maturity. As of April 1, 2011, our cash, cash equivalents and short-term investments balance was \$117.3 million. In a declining interest rate environment, as short term investments mature, reinvestment occurs at less favorable market rates. Given the short term nature of certain investments, declining interest rates would negatively impact investment income. Based on our estimates, a 100 basis point, or 1%, change in interest rates would have increased or decreased the fair value of our investments by approximately \$0.1 million as of April 1, 2011.

**ITEM 4. CONTROLS AND PROCEDURES***Evaluation of disclosure controls and procedures.*

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at a reasonable assurance level.

*Changes in internal controls.*

On September 15, 2010, we acquired Omneon and, as a result, we are in the process of integrating the processes, systems and controls relating to Omneon into our existing system of internal control over financial reporting in accordance with our integration plans. In addition, various transitional controls designed to supplement existing internal controls have been implemented with respect to the acquired processes and systems. Except for the processes, systems and controls relating to the integration of Omneon, there have not been any changes in the Company's internal control over financial reporting during the three months ended April 1, 2011 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

**Table of Contents**

**PART II**

**OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

On March 4, 2010, Interkey ELC Ltd, or Interkey, filed a lawsuit in Israel, alleging breach of contract against Harmonic and Scopus Video Networks Ltd. (now Harmonic Video Networks Ltd. or HVN ), which was acquired by Harmonic in March 2009, and Harmonic. The plaintiffs are seeking damages in the amount of 6,300,000 ILS (approximately \$1.7 million). Although, as is the case with all litigation, no assurances can be given as to the outcome of the Interkey lawsuit, Harmonic believes Interkey's and its shareholders claims are without merit and Harmonic and HVN intend to vigorously defend themselves against these claims.

In April 2010, Arris Corporation filed a complaint in United States District Court in Atlanta, alleging that our Streamliner 3000 product infringes four patents held by Arris. The complaint sought injunctive relief and damages. In connection with this matter, we recorded a \$1.3 million liability in the fourth quarter of 2010, based on a tentative agreement of Arris and Harmonic with respect to settlement of the action. In April 2011, this matter was settled on essentially the same terms as the tentative agreement, the Company paid Arris \$1.3 million, and the action was dismissed.

Harmonic is subject to other litigation incidental to its business that is not believed to be material to the Company.

**ITEM 1A. RISK FACTORS**

*We depend on cable, satellite and telco, and broadcast and media industry capital spending for a substantial majority of our revenue and any material decrease or delay in capital spending in these industries would negatively impact our operating results, financial condition and cash flows.*

A substantial majority of our historical revenue has been derived from sales to cable television operators, satellite and telco operators and broadcast companies, as well as, more recently, the emerging streaming media providers. In September 2010, we completed the acquisition of Omneon, a private, venture-backed company specializing in file-based infrastructure for the production, preparation and playout of video content typically deployed by broadcasters, satellite operators, content owners and other media companies. We expect revenue from all of these markets will constitute a substantial majority of revenue for the foreseeable future. Demand for our products will depend on the magnitude and timing of capital spending by customers in these markets for constructing and upgrading their systems.

These capital spending patterns are dependent on a variety of factors, including:

access to financing;

annual capital spending budget cycles of each of the industries we serve;

the impact of industry consolidation;

federal, local and foreign government regulation of telecommunications and television broadcasting;

overall demand for communication services and consumer acceptance of new video and data services;

evolving industry standards and network architectures;

competitive pressures, including pricing pressures;

discretionary end-user customer spending patterns; and

general economic conditions.

In the past, specific factors contributing to reduced capital spending have included:

uncertainty related to development of digital video industry standards;

delays in the evaluation of new services, new standards and system architectures by many operators;

**Table of Contents**

emphasis by operators on generating revenue from existing customers, rather than from new customers through new construction or network upgrades;

a reduction in the amount of capital available to finance projects of our customers and potential customers;

proposed and completed business combinations and divestitures by our customers and the length of regulatory review thereof;

weak or uncertain economic and financial conditions in domestic or international markets, particularly in the housing markets in the developed countries; and

bankruptcies and financial restructuring of major customers.

The financial difficulties of certain of our customers and changes in our customers' deployment plans have adversely affected our business in the past. In 2008 and 2009, economic conditions in many of the countries in which we sell products were very weak, and global economic conditions and financial markets experienced a severe downturn. The downturn stemmed from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Although there was an increase in global economic activity in 2010 and the first quarter of 2011, economic growth may remain sluggish during the balance of 2011 in a few developed countries and in some emerging market countries. The severity or length of time that these adverse economic and financial market conditions may persist, or whether such adverse conditions may return in the U.S. and in other countries, is unknown. During challenging or uncertain economic times, and in tight credit markets, many customers may delay or reduce capital expenditures, which in turn often results in lower demand for our products.

Further, we have a number of international customers to whom sales are denominated in U.S. dollars. The value of the U.S. dollar fluctuates significantly against many foreign currencies, which includes the local currencies of many of our international customers. If the U.S. dollar appreciates relative to the local currencies of our customers, then the prices of our products correspondingly increase for such customers. Such an effect could adversely impact sales of our products to such customers and result in longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition in the affected countries. Further, if the U.S. dollar were to weaken against many major currencies, there can be no assurance that a weaker dollar would lead to growth in capital spending.

In addition, industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. Further, if our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of customers in the markets on which we focus, our revenue may decline. As a result of these capital spending issues, we may not be able to maintain or increase our revenue in the future, and our operating results, financial condition and cash flows could be materially and adversely affected.

***The markets in which we operate are intensely competitive.***

The markets for our products are extremely competitive and have been characterized by rapid technological change and declining average selling prices. Pressure on average selling prices was particularly severe during previous economic downturns as equipment suppliers competed aggressively for customers' reduced capital spending, and we have experienced similar pressure during the recent economic slowdown.

Our principal competitors for edge and access products include Cisco Systems, Motorola and Arris. In the video processing solutions market, we compete broadly with products from vertically integrated system suppliers, including Motorola, Cisco Systems, Technicolor and Ericsson, and, in certain product lines, with a number of smaller companies. Our principal competitors for our production and playout products are Harris, Grass Valley, SeaChange and Avid.

Many of our competitors are substantially larger, and have greater financial, technical, marketing and other resources, than us. Many of these large enterprises are in a better position to withstand any significant reduction in capital spending by customers in these



**Table of Contents**

markets. They often have broader product lines and market focus, and may not be as susceptible to downturns in a particular market. These competitors may also be able to bundle their products together to meet the needs of a particular customer, and may be capable of delivering more complete solutions than we are able to provide. To the extent large enterprises that currently do not compete directly with us choose to enter our markets by acquisition or otherwise, competition would likely intensify.

Further, some of our competitors that have greater financial resources have offered, and in the future may offer, their products at lower prices than we offer for our competing products or more attractive financing terms, which has in the past, and may in the future, cause us to lose sales opportunities and the resulting revenue or to reduce our prices in response to that competition. Reductions in prices for any of our products could materially and adversely affect our operating margins and revenue. In addition, many of our competitors have been in operation longer than we have and, therefore, have more long-standing and established relationships with domestic and foreign customers, making it difficult for us to sell to those customers.

If any of our competitors' products or technologies were to become the industry standard, our business would be seriously harmed. If our competitors are successful in bringing their products to market earlier than us, or if these products are more technologically capable than ours, our revenue could be materially and adversely affected. In addition, certain companies that have not had a large presence in the broadband communications equipment market have begun to expand their presence in this market through mergers and acquisitions. The continued consolidation of our competitors could have a significant negative impact on our business. Further, our competitors, particularly companies that offer products that are competitive with our digital video systems, may bundle their products or incorporate functionality into existing products in a manner that discourages users from purchasing our products or which may require us to lower our selling prices, resulting in lower revenues and decreased gross margins.

If we are unable to compete at the same level as we have in the past, in any of our markets, or are forced to reduce the prices of our products in order to continue to be competitive, our operating results, financial condition and cash flows would be materially and adversely affected.

***We need to develop and introduce new and enhanced products in a timely manner to meet the needs of our customers and to remain competitive.***

All of the markets we address are characterized by continuing technological advancement, changes in customer requirements and evolving industry standards. To compete successfully, we must continually design, develop, manufacture and sell new or enhanced products that provide increasingly higher levels of performance and reliability and meet our customers changing needs. However, we may not be successful in those efforts if, among other things, our products:

- are not cost effective;

- are not brought to market in a timely manner;

- are not in accordance with evolving industry standards and architectures;

- fail to meet market acceptance or customer requirements; or

- are ahead of the market.

We are currently developing and marketing products based on established video compression standards. Encoding products based on the MPEG-2 compression standards have historically represented a significant portion of our revenue. Newer standards, such as MPEG-4 AVC/H.264, that have been adopted provide significantly greater compression efficiency, thereby making more bandwidth available to operators. The availability of more bandwidth is particularly important to those operators seeking to launch, or expand, HDTV services. We have developed and launched products, including HD encoders, based on these new standards in order to remain competitive, and are continuing to devote considerable resources to these efforts. In addition, we have launched an encoding platform that is capable of being configured for both MPEG-2 and MPEG-4, in both standard definition and HD formats. At the same time, we need to devote development resources to the existing MPEG-2 standard that many of our customers

continue to require. There can be no assurance that these efforts will be successful in the near future, or at all, or that competitors will not take significant market share in HD encoding.



**Table of Contents**

In addition, our customers are paying more attention to audio products and features than they have in the past. This enhanced attention to audio is likely to result in additional product requirements and the related need for more development and support staff with audio expertise and training. Hiring and retaining such staff may be difficult and costly. We cannot provide assurances that we will be able to timely hire development and support staff with audio expertise or that our efforts to develop enhanced audio products and features will be successful in the near future, or at all.

In order to successfully develop and market certain of our planned products, we may be required to enter into technology development or licensing agreements with third parties. We cannot provide assurances that we will be able to timely enter into any necessary technology development or licensing agreements on reasonable terms, or at all. If we fail to develop and market new and enhanced products, our operating results, financial condition and cash flows could be materially and adversely affected.

***Our operating results are likely to fluctuate significantly and, as a result, may fail to meet or exceed the expectations of securities analysts or investors, causing our stock price to decline.***

Our operating results have fluctuated in the past and are likely to continue to fluctuate in the future, on an annual and a quarterly basis, as a result of several factors, many of which are outside of our control. Some of the factors that may cause these fluctuations include:

- the level and timing of capital spending of our customers, both in the U.S. and in foreign markets, due in part to access to financing, including credit, for capital spending;

- economic and financial conditions specific to the cable, satellite and telco, and broadcast and media industries;

- changes in market demand for our products or customer's services or products;

- the timing and amount of orders, especially from significant customers;

- the timing of revenue recognition from solution contracts, which may span several quarters;

- increases and decreases in the number and size of relatively larger individual transactions, and projects in which we are involved, from quarter to quarter;

- the timing of revenue recognition on sales arrangements, which may include multiple deliverables;

- the timing of acquisitions and the financial impact of such acquisitions;

- the timing of completion of our customers' projects;

- competitive market conditions, including pricing actions by our competitors;

- lack of predictability in our revenue cycles;

- the level and mix of our international revenue;

- new product introductions by our competitors or by us;

- the timing of our development of custom products and software;

- changes in domestic and international regulatory environments affecting our business;

- market acceptance of our new or existing products;

impact of new revenue recognition accounting standards, which are effective in 2011;  
35

---

**Table of Contents**

the evaluation of new services, new standards and system architectures by our customers;

the cost and availability to us of components, subassemblies and modules;

the mix of our customer base, by industry and size, and sales channels;

the mix of our products sold and the effect it has on gross margins;

changes in our operating and extraordinary expenses, such as litigation expenses and settlement costs;

impairment of our goodwill and intangibles;

the outcome of litigation;

write-downs of inventory and investments;

the impact of applicable accounting guidance that requires us to record the fair value of stock options, restricted stock units and employee stock purchase plan awards as compensation expense;

changes in our effective tax rate, including as a result of changes in our valuation allowance against our deferred tax assets, changes in our effective state tax rates, including as a result of apportionment, and changes in our mix of domestic versus international revenue, as well as any changes to tax rules related to the deferral of foreign earnings and compliance with foreign tax rules;

the impact of applicable accounting guidance on accounting for uncertainty in income taxes that requires us to establish reserves for uncertain tax positions and accrue potential tax penalties and interest;

the impact of applicable accounting guidance on business combinations that requires us to record charges for certain acquisition related costs and expenses and generally to expense restructuring costs associated with a business combination subsequent to the acquisition date; and

general economic conditions.

The timing of deployment of our products by our customers can be subject to a number of other risks, including the availability of skilled engineering and technical personnel, the availability of other equipment, such as compatible set top boxes, our customers' ability to negotiate and enter into rights agreements with video content owners that provide the customers with the right to deliver certain video content, and our customers' need for local franchise and licensing approvals.

We often recognize a substantial portion of our quarterly revenues in the last month of the quarter. We establish our expenditure levels for product development and other operating expenses based on projected revenue levels for a specified period, and expenses are relatively fixed in the short term. Accordingly, even small variations in timing of revenue, particularly from relatively large individual transactions, can cause significant fluctuations in operating results in a particular quarter.

As a result of these factors and other factors, our operating results in one or more future periods may fail to meet or exceed the expectations of securities analysts or investors. In that event, the trading price of our common stock would likely decline.

***Our customer base is concentrated and we are regularly involved in relatively large transactions. The loss of one or more of our key customers, or a failure to diversify our customer base, as well as a decrease in the number of such larger transactions, could harm our business.***

Historically, a majority of our revenue has been derived from relatively few customers, due in part to the consolidation of the ownership of cable television and direct broadcast satellite system companies. However, in the last three years, revenue from our ten largest customers has decreased as a percentage of revenue, due to our growing customer base, in part as a result of the acquisitions of

**Table of Contents**

Scopus and Omneon. Sales to our ten largest customers in our first quarter of 2011 and our 2010 and 2009 fiscal years accounted for approximately 35%, 44% and 47% of revenue, respectively. Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration.

During our first quarter of 2011 and our 2010 and 2009 fiscal years, revenue from Comcast accounted for 11%, 17% and 16%, respectively, of our revenue. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, including, from time to time, projects in which we act much like a systems integrator. A decrease in the number of the relatively larger individual transactions in which we are involved in any quarter could adversely affect our operating results for that quarter. In addition, historically, we have been dependent upon capital spending in the cable and satellite industry. We are attempting to further diversify our customer base beyond cable and satellite customers, including to the telco and broadcast and media markets. Several major telcos have rebuilt or are upgrading their networks to offer bundled video, voice and data services. In order to be successful in this market, we may need to continue to build alliances with telco equipment manufacturers, adapt our products for telco applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the telco industry. In addition, telco video deployments, including recent trials of mobile video services, are subject to delays in completion, as video processing technologies and video business models are relatively new to most telcos and many of their largest suppliers. Implementation issues with our products or those of other vendors have caused, and may continue to cause, delays in project completion for our customers and delay our recognition of revenue.

As a result of these and other factors, we may be unable to increase our revenues from telco and broadcast and media customers and other markets, or to do so profitably, and any failure to increase revenues and profits from these customers could materially and adversely affect our operating results, financial condition and cash flows.

***If we do not realize improvement in our operating results and other benefits expected from our recently completed acquisition of Omneon, our business may be adversely affected and our stock price could decline.***

Our recently completed acquisition of Omneon, a private, venture-backed company specializing in file-based infrastructure for the production, preparation and playout of video content, involves the integration of a business that had previously operated independently. The integration of a previously independent company into the acquiring company's operations is a challenging, time-consuming and costly process. While the integration process for Omneon began in September 2010, when the Omneon acquisition was consummated, it will take additional time to complete the process. It is possible that the process of integrating Omneon could result in our inability to fully realize the expected synergies and other benefits of the acquisition, the loss of key employees, the disruption of our ongoing businesses and that of Omneon, and inconsistencies in standards, controls, procedures, and policies that adversely affect our ability to maintain relationships with customers, suppliers, and employees, and would involve many of the other risks of any acquisition described in the risk factor concerning acquisitions on page 43. In addition, the successful combination of the companies requires the dedication of significant management resources, which could divert attention from the day-to-day business of the combined company. There can be no assurance that these challenges will be met, and that we will realize the anticipated benefits from the acquisition of Omneon, on a timely basis or at all. If we are unable to realize these benefits, our goal of expanding into the markets on which Omneon focuses and our business, in general, may be adversely affected.

***We depend significantly on our international revenue and are subject to the risks associated with international operations, which may negatively affect our operating results.***

Revenue derived from customers outside of the U.S. in our first quarter of 2011 and in our 2010 and 2009 fiscal years represented 56%, 50% and 49% of our revenue, respectively. We expect that international revenue will continue to represent a similar substantial percentage of our revenue for the foreseeable future. Furthermore, most of our contract manufacturing occurs overseas. Our international operations, the international operations of our contract manufacturers and our efforts to maintain and increase revenue in international markets are subject to a number of risks, which are generally greater with respect to emerging market countries, including the impact on our business and

operating results of:

a slowdown or leveling off in international economies, which may adversely affect our customers' capital spending;

37

---

**Table of Contents**

changes in foreign government regulations and telecommunications standards;

import and export license requirements, tariffs, taxes and other trade barriers;

fluctuations in currency exchange rates;

a significant reliance on distributors, resellers and other third parties to sell our products and solutions, particularly in emerging market countries;

difficulty in collecting accounts receivable, especially from smaller customers and resellers, particularly in emerging market countries;

compliance with the U.S. Foreign Corrupt Practices Act, or FCPA, particularly in emerging market countries;

compliance with the U.K. Bribery Act, particularly in emerging market countries;

the burden of complying with a wide variety of foreign laws, treaties and technical standards;

fulfilling country of origin requirements for our products for certain customers;

difficulty in staffing and managing foreign operations;

political and economic instability, including risks related to terrorist activity, particularly in emerging market countries;

changes in economic policies by foreign governments;

lack of basic infrastructure, particularly in emerging market countries;

availability of credit, particularly in emerging market countries; and

impact of the recent escalating social and political unrest in the Middle East.

In the past, certain of our international customers accumulated significant levels of debt and have undertaken reorganizations and financial restructurings, including bankruptcy proceedings. Even where these restructurings have been completed, in some cases these customers have not been in a position to purchase new equipment at levels we had seen in the past.

While our international revenue and operating expenses have typically been denominated in U.S. dollars, fluctuations in currency exchange rates could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in revenue or profitability from sales in that country. A portion of our European business is denominated in Euros, which subjects us to increased foreign currency risk. Gains and losses on the conversion to U.S. dollars of accounts receivable, accounts payable and other monetary assets and liabilities arising from international operations may contribute to fluctuations in operating results.

Furthermore, payment cycles for international customers are typically longer than those for customers in the U.S. Unpredictable payment cycles could cause us to fail to meet or exceed the expectations of security analysts and investors for any given period.

Our operations outside the United States also require us to comply with a number of United States and international regulations. For example, our operations in countries outside the United States are subject to the FCPA and similar laws, which prohibits United States companies or their agents and employees from providing anything of value to a foreign official for the purposes of influencing any act or decision of these individuals, in their official capacity, to

help obtain or retain business, direct business to any person or corporate entity or obtain any unfair advantage. Our activities in countries outside the United States create the inherent risk of unauthorized payments or offers of payments by one of our employees or agents, including those companies to which we outsource certain of our business operations, which could be in violation of the FCPA, even though these parties are not always subject to our control. We have internal control policies and procedures, and have implemented training and compliance programs for our employees and agents, with respect to the FCPA. However, we cannot assure you that our policies, procedures and programs will prevent violations of the



**Table of Contents**

FCPA or similar laws by our employees or agents, particularly in emerging market countries, and as we expand our international operations. Any such violation, even if prohibited by our policies, could result in criminal or civil sanctions against us.

The effect of one or more of these international risks could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***Our future growth depends on market acceptance of several broadband services, on the adoption of new broadband technologies and on several other broadband industry trends.***

Future demand for many of our products will depend significantly on the growing market acceptance of emerging broadband services, including digital video, VOD, HDTV, IPTV, mobile video services, and very high-speed data services. The market demand for such emerging services is rapidly growing, with many de facto or proprietary systems in use, which increases the challenge of delivering interoperable products intended to address the requirements of such services.

The effective delivery of these services will depend, in part, on a variety of new network architectures and standards, such as:

- video compression standards, such as MPEG-4 AVC/H.264, for both standard definition and high definition services;

- fiber to the premises, or FTTP, and digital subscriber line, or DSL, networks designed to facilitate the delivery of video services by telcos;

- the greater use of protocols such as IP;

- the further adoption of bandwidth-optimization techniques, such as switched digital video and DOCSIS 3.0; and

- the introduction of new consumer devices, such as advanced set-top boxes, personal video recorders, or PVRs, and a variety of smart phone mobile devices, such as the iPhone.

If adoption of these emerging services and/or technologies is not as widespread or as rapid as we expect, or if we are unable to develop new products based on these technologies on a timely basis, our revenue will be materially and adversely affected.

Furthermore, other technological, industry and regulatory trends will affect the growth of our business. These trends include the following:

- convergence, or the need of many network operators to deliver a package of video, voice and data services to consumers, including mobile delivery options;

- the increasing availability of traditional broadcast video content on the Internet;

- the entry of telcos into the video business;

- the emergence of ATSC mobile handheld as a viable content delivery system;

- the use of digital video by businesses, governments and educational institutions;

- efforts by regulators and governments in the U.S. and abroad to encourage the adoption of broadband and digital technologies;

- increased consumer interest in 3D television and content;

- the extent and nature of regulatory attitudes towards such issues as network neutrality, competition between operators, access by third parties to networks of other operators, local franchising requirements for telcos to offer

video, and other new services, such as mobile video; and

39

---

**Table of Contents**

the outcome of litigation and negotiations between content owners and service providers regarding rights of service providers to store and distribute recorded broadcast content, which outcomes may drive adoption of one technology over another in some cases.

If we fail to recognize and respond to these trends, by timely developing products, features and services required by these trends, we are likely to lose revenue opportunities and our results of operations and stock price could be materially and adversely affected.

***Changes in telecommunications legislation and regulations could harm our prospects and future revenue.***

Changes in telecommunications legislation and regulations in the U.S. and other countries could affect the revenue from our products. In particular, regulations dealing with access by competitors to the networks of incumbent operators could slow or stop additional construction or expansion by these operators. Increased regulation of our customers' pricing or service offerings could limit their investments and, consequently, revenue from our products. The impact of new or revised legislation or regulations could have a material adverse effect on our business, operating results, financial condition and cash flows.

Newly adopted Federal laws will likely impact the demand for product features by our customers. These laws include the Commercial Advertisement Loudness Mitigation Act and the Twenty-First Century Communications and Video Accessibility Act of 2010, which deals with accessibility for the hearing and visually impaired. While we have added some features to our products in anticipation of these laws, others (driven by the regulatory process related to the laws) may require feature development on a schedule which may be inflexible and difficult to meet. This could result in our inability to develop other product features necessary for particular transactions at the same time, and thus we could lose some business and the related revenue.

***We purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources, and we are increasingly dependent on contract manufacturers and other subcontractors.***

Many components, subassemblies and modules necessary for the manufacture or integration of our products are obtained from a sole supplier or a limited group of suppliers. For example, we depend on a small private company for certain video encoding chips which are incorporated into several products. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our increased reliance on subcontractors for manufacturing and installation, involves several risks, including a potential inability to obtain an adequate supply of required components, subassemblies or modules and reduced control over costs, quality and timely delivery of components, subassemblies or modules and timely installation of products. In particular, certain optical components have in the past been in short supply and are available only from a small number of suppliers, including sole source suppliers. These risks could be heightened during a substantial economic slowdown, because our suppliers and subcontractors are more likely to experience adverse changes in their financial condition and operations during such a period. While we expend resources to qualify additional component sources, consolidation of suppliers in the industry and the small number of viable alternatives have limited the results of these efforts. Managing our supplier and contractor relationships is particularly difficult during time periods in which we introduce new products and during time periods in which demand for our products is increasing, especially if demand increases more quickly than we expect.

From time to time we assess our relationship with our contract manufacturers, and we do not generally maintain long-term agreements with any of our suppliers or contract manufacturers. Plexus Services Corp. acts as our primary contract manufacturer, and currently provides us with a majority of the products that we purchase from our contract manufacturers. Our agreement with Plexus has automatic annual renewals, unless prior notice is given by either party, and has been renewed until October 2011.

Since October 2009, most of the products previously manufactured by our Israeli operations have been outsourced to third party manufacturers located in Israel. Our ability to improve production efficiency with respect to that business may be limited by the terms of research grants that we received from the Israeli Office of the Chief Scientist, or OCS, an arm of the Israeli government. These grants restrict the transfer outside of Israel of intellectual property developed with funding from the OCS, and also limit the manufacturing outside of Israel of products containing such intellectual property.

Any difficulties in managing relationships with current contract manufacturers, particularly Plexus, which manufactures our products off-shore, could impede our ability to meet our customers requirements and adversely affect our operating results. An inability to obtain adequate and timely deliveries, or any other circumstance that would require us to seek alternative sources of supply, could negatively affect our ability to ship our products on a timely basis, which could damage relationships with current and prospective customers and harm our business and materially and adversely affect our revenues. We attempt to limit this risk by maintaining safety

**Table of Contents**

stocks of certain components, subassemblies and modules. Recent increases in demand on our suppliers and subcontractors from other parties have caused sporadic shortages of certain components and products. In response, we have increased our inventories of certain components and products and expedited shipments of our products when necessary, which has increased our costs. As a result of this investment in inventories, we have in the past been, and in the future may be, subject to risk of excessive or obsolete inventories, which, despite our use of a demand order fulfillment model, could materially and adversely affect our business, operating results, financial position and cash flows. In this regard, our gross margins and operating results have, in the past, been adversely affected by significant excess and obsolete inventory charges.

***Fluctuations in our future effective tax rates could affect our future operating results, financial condition and cash flows.***

We are required to periodically review our deferred tax assets and determine whether, based on available evidence, a valuation allowance is necessary. Accordingly, we have performed such evaluation, from time to time, based on historical evidence, trends in profitability, expectations of future taxable income and implemented tax planning strategies. In 2008, we determined that a valuation allowance was no longer necessary for substantially all of our U.S. deferred tax assets because, based on the available evidence, we concluded that realization of these net deferred tax assets was more likely than not. We continue to maintain a valuation allowance for certain foreign deferred tax assets, and recorded a valuation allowance on certain of our California deferred tax assets in the first quarter of 2009 as a result of our expectations of future usage of the California deferred tax assets. In the event, in the future, we determine an additional valuation allowance is necessary with respect to our U.S. and certain foreign deferred tax assets, we would incur a charge equal to the amount of the valuation allowance in the period in which we made such determination as a discrete item, and this could have a material and adverse effect on our results of operations for such period.

The calculation of tax liabilities involves dealing with uncertainties in the application of complex global tax regulations. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. In the event we determine that it is appropriate to create a reserve or increase an existing reserve for any such potential liabilities, the amount of the additional reserve is charged as an expense in the period in which it is determined. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. If the estimate of tax liabilities proves to be less than the ultimate tax assessment for the applicable period, a further charge to expense in the period such short fall is determined would result. Either such charge to expense could have a material and adverse effect on our results of operations for the applicable period. In addition, recent statements from the IRS have indicated their intent to seek greater disclosure by companies of their reserves for uncertain tax positions.

We have been notified by the Internal Revenue Service that our 2008 and 2009 U.S. corporate income tax return has been selected for audit, which commenced in the second quarter of 2011. If, upon the conclusion of these audits, the ultimate determination of taxes owed in the U.S. is for an amount in excess of the tax provision we have recorded in the applicable period, our overall tax expense, effective tax rate and results of operations could be materially and adversely impacted in the period of adjustment.

We have requested an Advanced Pricing Agreement with the Internal Revenue Service regarding our non-exclusive license of our intellectual property rights to one of our international subsidiaries in 2008, and our sharing of research and development costs with our international subsidiaries. If the Internal Revenue Service is unwilling to enter into such agreement on substantially the terms we have proposed and we are ultimately forced to settle on terms that are unfavorable to us, we may be required to take a charge to expense, in the period of the settlement, arising from such unfavorable terms that could have a material and adverse effect on our results of operations for such period. We completed the same non-exclusive license of Omneon intellectual property in the fourth quarter of 2010, and expect to request the Internal Revenue Service to enter into an Advanced Pricing Agreement with respect to the Omneon license, which will have the same risk to us as the Advanced Pricing Agreement we are presently negotiating. We continue to be in the process of expanding our international operations and staffing to better support our expansion into international markets. This expansion involves the implementation of an international structure that

includes, among other things, an international support center in Europe, a research and development cost-sharing arrangement, certain licenses and other contractual arrangements between us and our wholly-owned domestic and foreign subsidiaries. As a result of these changes, we anticipate that our consolidated pre-tax income will be subject to foreign tax at relatively lower tax rates when compared to the United States federal statutory tax rate and, as a consequence, our effective income tax rate is expected to be lower than the United States federal statutory rate.

**Table of Contents**

Our future effective income tax rates could be adversely affected if tax authorities challenge our international tax structure or if the relative mix of United States and international income changes for any reason. Accordingly, there can be no assurance that our income tax rate will be less than the United States federal statutory rate in future periods.

***We or our customers may face intellectual property infringement claims from third parties.***

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the telco industry have extensive patent portfolios. From time to time, third parties have asserted, and may assert in the future, patent, copyright, trademark and other intellectual property rights against us or our customers. Our suppliers and their customers, including us, may have similar claims asserted against them. A number of third parties, including companies with greater financial and other resources than us, have asserted patent rights to technologies that are important to us. Any future intellectual property litigation, regardless of its outcome, could result in substantial expense and significant diversion of the efforts of our management and technical personnel. An adverse determination in any such proceeding could subject us to significant liabilities, temporary or permanent injunctions or require us to seek licenses from third parties or pay royalties that may be substantial. Furthermore, necessary licenses may not be available on terms satisfactory to us, or at all. An unfavorable outcome on any such litigation matter could require that we pay substantial damages, could require that we pay ongoing royalty payments or could prohibit us from selling certain of our products. Any such outcome could have a material adverse effect on our business, operating results, financial position and cash flows.

In April 2010, Arris Corporation filed a complaint in United States District Court in Atlanta, alleging that our Streamliner 3000 product infringes four patents held by Arris. The complaint sought injunctive relief and damages. In connection with this matter, we recorded a \$1.3 million liability in the fourth quarter of 2010, based on a tentative agreement of Arris and Harmonic with respect to settlement of the action. In April 2011, this matter was settled on essentially the same terms as the tentative agreement, the Company paid Arris \$1.3 million, and the action was dismissed.

Our suppliers and customers may have intellectual property claims relating to our products asserted against them. We have agreed to indemnify some of our suppliers and most of our customers for patent infringement relating to our products. The scope of this indemnity varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorney's fees) incurred by the supplier or customer in connection with such claims.

***We may be the subject of litigation which, if adversely determined, could harm our business and operating results.***

In addition to the litigation discussed elsewhere herein, we may be subject to claims arising in the normal course of business. The costs of defending any litigation, whether cash expenses or in management time, could harm our business and materially and adversely affect our operating results and cash flows. An unfavorable outcome on any litigation matter could require that we pay substantial damages, or, in connection with any intellectual property infringement claims, could require that we pay ongoing royalty payments or could prohibit us from selling certain of our products. In addition, we may decide to settle any litigation, which could cause us to incur significant settlement costs. A settlement or an unfavorable outcome on any litigation matter could have a material adverse effect on our business, operating results, financial position and cash flows.

As an example, we have received letters from several of our customers, notifying us that the customer intends to exercise its indemnification rights in agreements between the customer and us with respect to a patent infringement claim brought against the customer that may cover products we have sold to the customer. Many of these notices arise out of a spate of patent infringement claims, and related litigation, made by the Multimedia Patent Trust ( MPT ), an affiliate of Alcatel-Lucent, against end-users of products used in the industries we address. Any such litigation by MPT may be very expensive to defend, and there could be significant financial exposure to each of such customers if MPT is successful in such litigation or in extracting a settlement of such claims. None of the notices we have received from a customer with respect to its indemnification rights related to the MPT litigation has demanded that we provide a defense for the customer against such claims or litigation, or currently reimburse the customer for its costs of such defense, or pay any other specified sum to the customer. At this time, we cannot predict whether the claims by MPT are legitimate or actually cover any of our products, whether any of the claims may result in a settlement or judgment against a customer defendant, or whether we would have liability under our indemnification obligations for defense or

settlement costs or damages paid by any customer defendant. In the event one or more of our customers makes an indemnification claim against us with respect to a specific amount of defense or settlement costs or damages it suffers as a result of such MPT claims or litigation, we could be obligated to pay amounts to such customers that would materially and adversely affect our operating results, financial condition and cash flows.



**Table of Contents**

***We rely on distributors, value-added resellers and systems integrators for a significant portion of our revenue, and disruptions to, or our failure to develop and manage, our relationships with these customers and the processes and procedures that support them could adversely affect our business.***

We generate a significant portion of our revenue through sales to distributors, value-added resellers, or VARs, and systems integrators, principally to assist us with fulfillment or installation obligations. We expect that these sales will continue to generate a significant percentage of our revenue in the future. Accordingly, our future success is highly dependent upon establishing and maintaining successful relationships with a variety of distributors. Our reliance on VARs and systems integrators that specialize in video delivery solutions, products and services has increased since the completion of our acquisition of Omneon in September 2010.

We generally have no long-term contracts or minimum purchase commitments with any of our distributor, VAR or system integrator customers, and our contracts with these parties do not prohibit them from purchasing or offering products or services that compete with ours. Our competitors may provide incentives to our distributor, VAR and systems integrator customers to favor their products or, in effect, to prevent or reduce sales of our products. Our distributor, VAR or systems integrator customers may independently choose not to purchase or offer our products. Many of our distributors, VARs and system integrators are small, are based in a variety of international locations, and may have relatively unsophisticated processes and limited financial resources to conduct their business. Any significant disruption of our sales to these customers, including as a result of the inability or unwillingness of these customers to continue purchasing our products, or their failure to properly manage their business with respect to the purchase of and payment for our products, could materially and adversely impact our business, operating results, financial condition and cash flows. In addition, our failure to continue to establish or maintain successful relationships with distributor, VAR and systems integrator customers could likewise materially and adversely affect our business, operating results, financial condition and cash flows.

***We have made, and expect to continue to make, acquisitions, and any acquisition could disrupt our operations and materially and adversely affect our operating results and financial condition.***

As part of our business strategy, from time to time we have acquired, and we continue to consider acquiring, businesses, technologies, assets and product lines that we believe complement or expand our existing business. Most recently, in September 2010, we completed the acquisition of Omneon, a privately-held company that provides broadcast video server and storage systems used for video production and play-to-air workflows. It is likely that we will make additional acquisitions, from time to time, in the future.

We may face challenges as a result of these acquisition activities, because such activities entail numerous risks, including:

- the possibility that an acquisition may not close because of, among other things, a failure of a party to satisfy the conditions to closing or an acquisition target entering into an alternative transaction;

- unanticipated costs or delays associated with the acquisition;

- difficulties in the assimilation and integration of acquired operations, technologies and/or products;

- the diversion of management's attention from the regular operations of the business and the challenges of managing a larger and more geographically widespread operation and product portfolio;

- difficulties in integrating acquired companies' systems, controls, policies and procedures to comply with the internal control over financial reporting requirements of the Sarbanes-Oxley Act of 2002;

- adverse effects on new and existing business relationships with suppliers, contract manufacturers and customers;

- channel conflicts and disputes between distributors and other partners of ours and the acquired companies;

- potential difficulties in completing projects associated with in-process research and development;

risks associated with entering markets in which we may have no or limited prior experience;  
43

---

**Table of Contents**

the potential loss of key employees of acquired businesses;

difficulties in the assimilation of different corporate cultures and practices;

difficulties in bringing acquired products and businesses into compliance with applicable legal requirements in jurisdictions in which we operate and sell products;

substantial charges for acquisition costs, which are required to be expensed under accounting guidance on business combinations;

substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items;

substantial impairments to goodwill or intangible assets in the event that an acquisition proves to be less valuable than the price we paid for it; and

delays in realizing, or failure to realize, the anticipated benefits of an acquisition.

Competition within our industry for acquisitions of businesses, technologies, assets and product lines has been, and is likely to continue to be, intense. As such, even if we are able to identify an acquisition that we would like to consummate, we may not be able to complete the acquisition on commercially reasonable terms or because the target chooses to be acquired by another company. Furthermore, in the event that we are able to identify and consummate any future acquisitions, we may, in each of those acquisitions:

issue equity securities which would dilute current stockholders' percentage ownership;

incur substantial debt to finance the acquisition or by assumption of such debt in the acquisition;

incur significant acquisition-related expenses;

assume substantial liabilities, contingent or otherwise; or

expend significant cash.

These financing activities or expenditures could materially and adversely affect our operating results and financial condition or the price of our common stock, or both. Alternatively, due to difficulties in the capital or credit markets, we may be unable to secure capital on reasonable terms, or at all, necessary to complete an acquisition.

Moreover, even if we were to obtain benefits from acquisitions in the form of increased revenue and earnings per share, there may be a delay between the time the expenses associated with an acquisition are incurred and the time we recognize such benefits.

If we are unable to successfully address any of these risks, our business, operating results, financial condition and cash flows could be materially and adversely affected.

***Conditions and changes in some national and global economic environments may adversely affect our business and financial results.***

Adverse economic conditions in geographic markets in which we operate may harm our business. Recently, as described in the first risk factor in this section, economic conditions in some countries in which we sell products, principally emerging market countries, have been weak. That weakness is principally the result of global financial markets having experienced a severe downturn, stemming from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Economic growth in the U.S. and in many other countries slowed in the fourth quarter of 2007, slowed further or remained relatively flat in 2008 and 2009 and remained relatively flat in

2010, improving in the U.S. toward the end of the year. The global economic slowdown led many of our customers to decrease their expenditures in 2009, and we believe that this slowdown caused certain of our customers to reduce or delay orders for our products. Many of our

**Table of Contents**

international customers, particularly those in emerging markets, have been exposed to tight credit markets and depreciating currencies, further restricting their ability to build out or upgrade their networks. Some customers have had difficulty in servicing or retiring existing debt, and the financial constraints on certain international customers required us to significantly increase our allowance for doubtful accounts in the fourth quarter of 2008.

During challenging economic times, and in tight credit markets, many customers may delay or reduce capital expenditures. This could result in reductions in revenue of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition. If global economic and market conditions, or economic conditions in the U.S. or other key markets, remain weak or deteriorate further, we could experience a material and adverse impact on our business, results of operations, financial condition and cash flows.

***Broadband communications markets are characterized by rapid technological change.***

Broadband communications markets are subject to rapid changes, making it difficult to accurately predict the markets future growth rates, sizes or technological directions. In view of the evolving nature of these markets, it is possible that pay TV service providers, broadcasters, content providers and other video production and delivery companies will decide to adopt alternative architectures, new business models, and/or technologies that are incompatible with our current or future products. In addition, successful new entrants into the media markets, both domestic and international, may impact existing industry business models, resulting in decreased spending by our existing customer base. Finally, decisions by customers to adopt new technologies or products are often delayed by extensive evaluation and qualification processes, which can result in delays in revenue of current and new products. If we are unable to design, develop, manufacture and sell products that incorporate, or are compatible with, these new architectures or technologies, our business, operating results, financial condition and cash flows will be materially and adversely affected.

***In order to manage our growth, we must be successful in addressing management succession issues and attracting and retaining qualified personnel.***

Our future success will depend, to a significant extent, on the ability of our management to operate effectively, both individually and as a group. We must successfully manage transition and replacement issues that may result from the departure or retirement of members of our executive management, whether in the context of an acquisition or otherwise. We cannot provide assurances that changes of management personnel in the future would not cause disruption to our operations or customer relationships or a decline in our operating results.

We are also dependent on our ability to retain and motivate our existing highly qualified personnel, in addition to attracting new highly qualified personnel. Competition for qualified management, technical and other personnel is often intense, and we may not be successful in attracting and retaining such personnel. Competitors and others have in the past attempted, and are likely in the future to attempt, to recruit our employees. While our employees are required to sign standard agreements concerning confidentiality and ownership of inventions, we generally do not have employment contracts or non-competition agreements with any of our personnel. The loss of the services of any of our key personnel, the inability to attract or retain highly qualified personnel in the future or delays in hiring such personnel, particularly senior management and engineers and other technical personnel, could negatively affect our business and our results of operations.

***We may need additional capital in the future and may not be able to secure adequate funds on terms acceptable to us.***

We have been engaged in the design, manufacture and sale of a variety of video products and system solutions since inception, which has required, and will continue to require, significant research and development expenditures. As a result, we have generated substantial operating losses from the time we began operations in 1988. These losses have had an adverse effect on our stockholders' equity and working capital. As of December 31, 2010, we had an accumulated deficit of \$1.9 billion.

In September 2010, we completed the acquisition of Omneon. The purchase price was approximately \$251.3 million, which included approximately \$153.3 million in cash, net of \$40.5 million of cash acquired. The cash portion of the purchase price was paid from then existing cash balances.

Taking into account the acquisition of Omneon and the use of approximately \$153.3 million of cash to complete the transaction, we believe that our existing cash of \$117.3 million, at April 1, 2011, will satisfy our cash requirements for at least the next twelve months.

**Table of Contents**

However, we may need to raise additional funds if our expectations are incorrect, to take advantage of presently unanticipated strategic opportunities, to satisfy our other cash requirements from time to time, or to strengthen our financial position. Our ability to raise funds may be adversely affected by a number of factors, including factors beyond our control, such as weakness in the economic conditions in markets in which we sell our products and continued uncertainty in the financial, capital and credit markets. There can be no assurance that equity or debt financing will be available to us on reasonable terms, if at all, when and if it is needed.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital to finance the acquisition and related expenses, as well as to integrate operations following the acquisition, and could require us to issue our stock and dilute existing stockholders.

We may raise additional financing through public or private equity offerings, debt financings, or corporate partnership or licensing arrangements. To the extent we raise additional capital by issuing equity securities or convertible debt, our stockholders may experience dilution. To the extent that we raise additional funds through collaboration and licensing arrangements, it may be necessary to relinquish some rights to our technologies or products, or grant licenses on terms that are not favorable to us. To the extent we raise capital through debt financing arrangements, we may be required to pledge assets or enter into covenants that could restrict our operations or our ability to incur further indebtedness.

If adequate capital is not available, or is not available on reasonable terms, when needed, we may not be able to take advantage of acquisition or other market opportunities, to timely develop new products or to otherwise respond to competitive pressures.

***We may not be able to effectively manage our operations.***

In recent years, the Company has grown significantly, principally through acquisitions, and expanded our international operations. Upon the closing of our acquisition of Scopus in the first quarter of 2009, we added 221 employees, most of whom are based in Israel. Upon the closing of the acquisition of Omneon in September 2010, we added 286 employees, most of whom are based in the U.S. In addition, as of April 1, 2011, we have 447 employees in our international operations, representing approximately 40% of our worldwide workforce. Our ability to manage our business effectively in the future, including with respect to any future growth, the integration of recent and any future acquisitions, and the breadth of our international operations, will require us to train, motivate and manage our employees successfully, to attract and integrate new employees into our overall operations, to retain key employees and to continue to improve our operational, financial and management systems. There can be no assurances that we will be successful in that regard, and our failure to effectively manage our operations could have a material and adverse effect on our business, operating results and financial condition.

***Our failure to adequately protect our proprietary rights may adversely affect us.***

As of April 1, 2011, we hold 54 issued U.S. patents and 13 issued foreign patents, and have a number of patent applications pending. Although we attempt to protect our intellectual property rights through patents, trademarks, copyrights, licensing arrangements, maintaining certain technology as trade secrets and other measures, we can give no assurances that any patent, trademark, copyright or other intellectual property rights owned by us will not be invalidated, circumvented or challenged, that such intellectual property rights will provide competitive advantages to us, or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. We can give no assurances that others will not develop technologies that are similar or superior to our technologies, duplicate our technologies or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or may do business in the future.

We believe that patents and patent applications are not currently significant to our business, and we do not rely on our patent portfolio to give us a competitive advantage over others in our industry. We believe that the future success of our business will depend on our ability to translate the technological expertise and innovation of our personnel into new and enhanced products. We generally enter into confidentiality or license agreements with our employees, consultants, and vendors and our customers, as needed, and generally limit access to, and distribution of, our proprietary information. Nevertheless, we cannot provide assurances that the steps taken by us will prevent

misappropriation of our technology. In addition, we have taken in the past, and may take in the future, legal action to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the



**Table of Contents**

proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of management time and other resources, and could negatively affect our business, operating results, financial position and cash flows.

In order to successfully develop and market certain of our planned products, we may be required to enter into technology development or licensing agreements with third parties. Although many companies are often willing to enter into technology development or licensing agreements, we cannot assure you that such agreements may be negotiated on reasonable terms, or at all. The failure to enter into technology development or licensing agreements, when necessary or desirable, could limit our ability to develop and market new products and could materially and adversely affect our business.

***Our products include third-party technology and intellectual property, and our inability to use that technology in the future could harm our business.***

We incorporate certain third-party technologies, including software programs, into our products, and intend to utilize additional third-party technologies in the future. Licenses to relevant third-party technologies or updates to those technologies may not continue to be available to us on commercially reasonable terms, or at all. In addition, the technologies that we license may not operate properly or as specified, and we may not be able to secure alternatives in a timely manner, either of which could harm our business. We could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our products, if we are able to do so at all. These delays, or a failure to secure or develop adequate technology, could materially and adversely affect our business.

***We face risks associated with having important facilities and resources located in Israel.***

We maintain facilities in two locations in Israel with a total of 222 employees, or approximately 20% of our worldwide workforce, as of April 1, 2011. Our employees in Israel engage in a number of activities, including research and development, the development of, and supply chain management, for one product line, and sales activities.

We are directly influenced by the political, economic and military conditions affecting Israel. Any significant conflict involving Israel could have a direct effect on our business or that of our Israeli contract manufacturers, in the form of physical damage or injury, reluctance to travel within or to Israel by our Israeli and other employees or those of our subcontractors, or the loss of Israeli employees to active military duty. Most of our employees in Israel are currently obligated to perform annual reserve duty in the Israel Defense Forces, and several have been called for active military duty in recent years. In the event that more employees are called to active duty, certain of our research and development activities may be adversely affected, including significantly delayed. In addition, the interruption or curtailment of trade between Israel and its trading partners, as a result of terrorist attacks or hostilities, conflicts between Israel and any other Middle Eastern country or any other cause, could significantly harm our business. Current or future tensions in the Middle East could materially and adversely affect our business, results of operations and financial condition.

Further, the Israeli government grants that we received for research and development expenditures limit our ability to manufacture products and transfer technologies outside of Israel, and, if we fail to satisfy specified conditions in the grants, we may be required to refund such grants, together with interest and penalties, and may be subject to criminal charges.

***We are subject to import and export controls that could subject us to liability or impair our ability to compete in international markets.***

Our products are subject to U.S. export controls, and may be exported outside the United States only with the required level of export license or through an export license exception, in most cases because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain technology and have enacted laws that could limit our ability to distribute our products, or could limit our customers' ability to implement our products, in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to

the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers internationally.

**Table of Contents**

In addition, we may be subject to customs duties that could have a significant adverse impact on our operating results or, if we are able to pass on the related costs in any particular situation, would increase the cost of the related product to our customers. As a result, the future imposition of significant increases in the level of customs duties or the creation of import quotas on our products in Europe or in other jurisdictions, or any of the limitations on international sales described above, could have a material adverse effect on our business, operating results, financial condition and cash flows. Further, some of our customers in Europe have been, or are being, audited by local governmental authorities regarding the tariff classifications used for importation of our products. Import duties and tariffs vary by country and a different tariff classification for any of our products may result in higher duties or tariffs, which could have an adverse impact on our operating results and potentially increase the cost of the related products to our customers.

***The ongoing threat of terrorism and social and political instability have created uncertainty and may harm our business.***

Conditions in the U.S. and global economies have improved over the last 18 months, but remain uncertain. The terrorist attacks in the U.S. in 2001 and subsequent terrorist attacks in other parts of the world have created many economic and political uncertainties that have adversely impacted the global economy and, as a result, have adversely affected our business. The long-term effects of such attacks, of the ongoing war on terrorism, and of the recently increased social and political instability, particularly in the Middle East, on our business and the global economy remain unknown. Such uncertainty has increased the price of certain commodities, particularly oil, which could have an indirect adverse impact on the cost of manufacturing and shipping our products. Moreover, the potential for future terrorist attacks, and increases in such social and political instability, make it difficult to estimate the long-term stability and strength of the U.S. and other economies, particularly those in certain emerging market countries, and the impact of resulting economic conditions on our business.

***The Company's operating results could be adversely affected by natural disasters affecting the Company or impacting our third-party manufacturers, suppliers, distributors or customers.***

Our headquarters and the majority of our operations are located in California, which is prone to earthquakes. In the event that any of our business centers are adversely affected by an earthquake or by any other natural disaster, we may sustain damage to our operations and properties and suffer significant financial losses.

We rely on third-party manufacturers for the production of most of our products. Any significant disruption in the business or operations of such manufacturers or of our suppliers could adversely impact our business. Our principal third-party manufacturer and several of our suppliers, distributors and customers have operations in locations that are subject to natural disasters, such as severe weather and earthquakes, which could disrupt their operations and, in turn, our operations. In addition, if there is a major earthquake or other natural disaster in any of the locations in which our significant customers are located, we face the risk that our customers may incur losses, or sustained business interruption and/or loss, which may materially impair their ability to continue their purchase of products from us. Accordingly, a major earthquake or other natural disaster in the markets in which we, or our third-party manufacturers, suppliers or customers, operate could have a material adverse effect on our business, operating results, cash flows and financial condition.

For example, in March 2011, the northern region of Japan experienced a severe earthquake followed by a tsunami. These geological events caused significant damage in that region and have adversely affected Japan's infrastructure and economy. These events could adversely affect the operations of some or all of our customers, distributors and suppliers located in Japan.

As a result of such impacts, some or all of our customers in Japan, and potentially in other countries, may ultimately cancel, postpone or reduce their orders for our products, which could adversely affect our revenue, cash flows and results of operations. In addition, some or all of our suppliers in Japan, and potentially in other countries, may be unable to provide us with components consistent with our requirements as to quality, quantity and timeliness, which could cause delays in production and shipment of our products, loss of sales, increases in costs and lower gross margins, which could adversely affect our operating results, cash flows and financial condition. Furthermore, if we are required to obtain one or more new suppliers for components or use alternative components in our products, we may need to conduct additional testing of our products to ensure those components meet our quality and performance

standards, all of which could delay shipments to our customers and adversely affect our operating results and cash flows.

In addition to the negative direct economic effects of recent events on the Japanese economy and on our suppliers, distributors and

**Table of Contents**

customers located in Japan, or otherwise impacted by such events, economic conditions in Japan could also adversely affect regional and global economic conditions. Whether, and the degree to which, these events, as well as future events, in Japan will adversely affect regional and global economies remains uncertain at this time. However, if these events cause a decrease in demand for our products, our operating results, cash flows and financial condition could be adversely affected.

We are currently evaluating the consequences that the earthquake and related events in Japan may have on our operations; however, it is too early to determine whether the impact could be adverse or, if adverse, be material. To date, we have not experienced significant disruptions in the supply of components for our products or in the manufacture of our products by our third-party manufacturers, or in orders from our Japanese distributors or customers, as a result of those events. However, we can provide no assurance that those events will not have a material adverse impact on our business in the future. We are currently unable to quantify the depth or duration or the impact these events may have on the Company, but are working to further understand and mitigate any potential impact.

***Negative conditions in the global credit and financial markets may impair the liquidity or the value of a portion of our investment portfolio.***

The recent negative conditions in the global credit and financial markets have had an adverse impact on the liquidity of certain investments. In the event we need or desire to access funds from the short-term investments that we hold, it is possible that we may not be able to do so due to market conditions. If a buyer is found, but is unwilling to purchase the investments at par or our cost, we may incur a loss. Further, rating downgrades of the security issuer or the third parties insuring such investments may require us to adjust the carrying value of these investments through an impairment charge. For example, during 2008, we recorded an impairment charge of \$0.8 million relating to an investment in an unsecured debt instrument of Lehman Brothers Holdings, Inc. Our inability to sell all or some of our short-term investments at par or our cost, or rating downgrades of issuers or insurers of these securities, could materially and adversely affect our results of operations, financial condition and cash flows.

In addition, we invest our cash, cash equivalents and short-term investments in a variety of investment vehicles, in a number of countries, with, and in the custody of, financial institutions with high credit ratings. While our investment policy and strategy attempt to manage interest rate risk, limit credit risk, and only invest in what we view as very high-quality securities, the outlook for our investment holdings is dependent on general economic conditions, interest rate trends and volatility in the financial marketplace, which can all affect the income that we receive, the value of our investments and our ability to sell them.

We believe that our investment securities are carried at fair value. However, over time the economic and market environment in which we conduct business may provide us with additional insight regarding the fair value of certain securities in our portfolio that could change our judgment regarding impairment of those securities. This could result in unrealized or realized losses in our securities, relating to other than temporary declines, being charged against income. Given the current market conditions involved, there is continuing risk that further declines in fair value of our portfolio securities may occur and additional impairments may be charged to income in future periods.

***If demand for our products increases more quickly than we expect, we may be unable to meet our customers requirements.***

If demand for our products increases, the difficulty of accurately forecasting our customers requirements and meeting these requirements will increase. Forecasting to meet customers needs and effectively managing our supply chain is particularly difficult in connection with newer products. Our ability to meet customer demand depends significantly on the availability of components and other materials, as well as the ability of our contract manufacturers to scale their production. Furthermore, we purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources. Our ability to meet customer requirements depends in part on our ability to obtain sufficient volumes of these materials in a timely fashion. Increases in demand on our suppliers and subcontractors from other customers may cause sporadic shortages of certain components and products. In order to be able to respond to these issues, we have increased our inventories of certain components and products, particularly for our customers that order significant dollar amounts of our products, and expedited shipments of our products when necessary, which has increased our costs and could increase our risk of holding obsolete or excessive

inventory. We also employ a demand order fulfillment model which is designed to mitigate the effects of increases or decreases in demand for any products. Nevertheless, we may be unable to respond to customer demand that increases more quickly than we expect. If we fail to meet customers' supply expectations, our revenue would be adversely affected and we may lose business, which could materially and adversely affect our operating results, financial condition and cash flows.

**Table of Contents**

***We are subject to various laws and regulations related to the environment and potential climate change that could impose substantial costs upon us and may adversely affect our business, operating results and financial condition.***

Our operations are regulated under various federal, state, local and international laws relating to the environment and potential climate change, including those governing the management, disposal and labeling of hazardous substances and wastes and the cleanup of contaminated sites. We could incur costs and fines, third-party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs, if we were to violate or become liable under environmental laws. The ultimate costs to us under these laws and the timing of these costs are difficult to predict.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling, and disposal of certain products. For example, the European Parliament and the Council of the European Union have enacted the Waste Electrical and Electronic Equipment (WEEE) directive, which regulates the collection, recovery, and recycling of waste from electrical and electronic products, and the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, which bans the use of certain hazardous materials, including lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyls (PBBs), and polybrominated diphenyl ethers (PBDEs) that exceed certain specified levels. Legislation similar to RoHS and WEEE has been or may be enacted in other jurisdictions, including in the United States, Japan and China. Our failure to comply with these laws could result in our being directly or indirectly liable for costs, fines or penalties and third-party claims, and could jeopardize our ability to conduct business in such regions and countries.

We also expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we redesign or change how we manufacture our products, any of which could have a material adverse effect on our business, operating results, financial condition and cash flows.

***Some anti-takeover provisions contained in our certificate of incorporation, bylaws and stockholder rights plan, as well as provisions of Delaware law, could impair a takeover attempt.***

We have provisions in our certificate of incorporation and bylaws that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our Board of Directors. These include provisions:

authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;

limiting the liability of, and providing indemnification to, our directors and officers;

limiting the ability of our stockholders to call, and bring business before, special meetings;

requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our Board of Directors;

controlling the procedures for conduct and scheduling of Board and stockholder meetings; and

providing the Board of Directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

These provisions, alone or together, could delay hostile takeovers or changes in control of us or our management. In addition, we have adopted a stockholder rights plan. The rights are not intended to prevent a takeover, and we believe these rights will help us in our negotiations with any potential acquirers. However, if the Board of Directors believes that a particular acquisition of us is undesirable, the rights may have the effect of rendering more difficult or discouraging that acquisition. The rights would cause substantial dilution to a person or group that attempts to acquire us on terms, or in a manner, not approved by our Board of Directors, except pursuant to an offer conditioned upon redemption of the rights.





## **Table of Contents**

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock.

Any provision of our certificate of incorporation or bylaws, our stockholder rights plan or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

***Our common stock price may be extremely volatile, and the value of an investment in our stock may decline.***

Our common stock price has been highly volatile. We expect that this volatility will continue in the future due to factors such as:

general market and economic conditions;

actual or anticipated variations in operating results;

announcements of technological innovations, new products or new services by us or by our competitors or customers;

changes in financial estimates or recommendations by stock market analysts regarding us or our competitors;

announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

announcements by our customers regarding end market conditions and the status of existing and future infrastructure network deployments;

additions or departures of key personnel; and

future equity or debt offerings or our announcements of these offerings.

In addition, in recent years, the stock market in general, and the NASDAQ Stock Market and the securities of technology companies in particular, have experienced extreme price and volume fluctuations. These fluctuations have often been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations have in the past, and may in the future, materially and adversely affect our stock price, regardless of our operating results. In these circumstances, investors may be unable to sell their shares of our common stock at or above their purchase price over the short term, or at all.

***Our stock price may decline if additional shares are sold in the market or if analysts drop coverage of or downgrade our stock.***

Future sales of substantial amounts of shares of our common stock by our existing stockholders in the public market, or the perception that these sales could occur, may cause the market price of our common stock to decline. In addition, we will be required to issue substantial amounts of additional shares upon exercise of stock options or grants of restricted stock units. Increased sales of our common stock in the market after exercise of outstanding stock options or grants of restricted stock units could exert downward pressure on our stock price. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price we deem appropriate.

The trading market for our common stock relies in part on the availability of research and reports that third-party industry or securities analysts publish about us. If one or more of the analysts who do cover us downgrade our stock, our stock price may decline. If one or more of these analysts cease coverage of us, we could lose visibility in the market, which in turn could cause the liquidity of our stock and our stock price to decline.

***We are exposed to additional costs and risks associated with complying with increasing regulation of corporate governance and disclosure standards.***

We have been spending a substantial amount of management time and costly external resources to comply with changes in laws,

**Table of Contents**

regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations and the NASDAQ Stock Market rules. In particular, Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting and attestation of the effectiveness of our internal control over financial reporting by our independent registered public accounting firm in connection with the filing of our Report on Form 10-K for each fiscal year. We have documented and tested our internal control systems and procedures and have made improvements in order for us to comply with the requirements of Section 404. This process has required us to hire additional personnel and outside advisory services and has resulted in significant additional expenses.

While our management's assessment of our internal control over financial reporting resulted in our conclusion that, as of December 31, 2010, our internal control over financial reporting was effective, and our independent registered public accounting firm has attested that our internal control over financial reporting was effective in all material respects as of December 31, 2010, we cannot predict the outcome of our testing and that of our independent registered public accounting firm in future periods. If we conclude in future periods that our internal control over financial reporting is not effective or if our independent registered public accounting firm is unable to provide an unqualified attestation as of future year-ends, we will incur substantial additional costs in an effort to correct such problems and investors may lose confidence in our financial statements, and the price of our stock will likely decrease in the short term, until we correct such problems, and perhaps in the long term, as well.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 5. OTHER INFORMATION**

None.

**Table of Contents**

**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Exhibit Index</b>
10.44	Amendment No. 8 to Second Amended and Restated Loan and Security Agreement
31.1	Section 302 Certification of Principal Executive Officer
31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Principal Executive Officer
32.2	Section 906 Certification of Principal Financial Officer
101***	The following materials from Registrant's Quarterly Report on Form 10-Q for the quarter ended April 1, 2011, formatted in Extensible Business Reporting Language (XBRL) includes: Condensed Consolidated Balance Sheets at April 1, 2011 and December 31, 2010, (ii) Condensed Consolidated Statements of Operations for the Three Months Ended April 1, 2011 and April 2, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the Three Months Ended April 1, 2011 and April 2, 2010, and (iv) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.
***	XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Exchange Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

**Table of Contents**

**SIGNATURES**

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

HARMONIC INC.

By: /s/ Carolyn V. Aver  
Carolyn V. Aver  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)  
Date: May 11, 2011

54