

HARMONIC INC  
Form 10-Q  
May 05, 2014  
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 March 28, 2014

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 (I.R.S. Employer  
incorporation or organization) 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 18, 2014 was 94,781,152.

---

Table of Contents

TABLE OF CONTENTS

PART I

<u>ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)</u>	<u>3</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>20</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>29</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>30</u>

PART II

<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>32</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>32</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>49</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>50</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>50</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>50</u>
<u>ITEM 6. EXHIBITS</u>	<u>51</u>
<u>SIGNATURES</u>	<u>52</u>

Table of ContentsPART I  
FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTSHARMONIC INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

	March 28, 2014	December 31, 2013
	(In thousands, except par value amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 69,192	\$ 90,329
Short-term investments	78,547	80,252
Accounts receivable, net	77,515	75,052
Inventories	30,304	36,926
Deferred income taxes	25,831	24,650
Prepaid expenses and other current assets	28,216	21,521
Total current assets	309,605	328,730
Property and equipment, net	34,103	34,945
Goodwill	198,036	198,022
Intangibles, net	24,453	31,119
Other assets	8,552	13,268
Total assets	\$ 574,749	\$ 606,084
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 19,847	\$ 22,380
Income taxes payable	98	331
Deferred revenue	33,528	27,020
Accrued liabilities	31,848	35,349
Total current liabilities	85,321	85,080
Income taxes payable, long-term	15,353	15,165
Other non-current liabilities	11,594	11,673
Total liabilities	112,268	111,918
Commitments and contingencies (Note 14)		
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; 95,735 and 99,413 shares issued and outstanding at March 28, 2014 and December 31, 2013, respectively	96	99
Additional paid-in capital	2,309,955	2,336,275
Accumulated deficit	(1,847,409	) (1,841,999
Accumulated other comprehensive loss	(161	) (209
Total stockholders' equity	462,481	494,166
Total liabilities and stockholders' equity	\$ 574,749	\$ 606,084
The accompanying notes are an integral part of these condensed consolidated financial statements.		

Table of Contents

HARMONIC INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (UNAUDITED)

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands, except per share amounts)	
Product revenue	\$88,260	\$82,475
Service revenue	19,772	19,197
Net revenue	108,032	101,672
Product cost of revenue	44,606	45,237
Service cost of revenue	11,114	10,270
Total cost of revenue	55,720	55,507
Gross profit	52,312	46,165
Operating expenses:		
Research and development	23,888	25,251
Selling, general and administrative	33,547	33,269
Amortization of intangibles	1,950	2,088
Restructuring and related charges	149	424
Total operating expenses	59,534	61,032
Loss from operations	(7,222)	(14,867)
Interest income, net	77	64
Other income (expense), net	12	(167)
Loss from continuing operations before income taxes	(7,133)	(14,970)
(Benefit from) provision for income taxes	(1,723)	(5,467)
Loss from continuing operations	(5,410)	(9,503)
Income from discontinued operations, net of taxes (including gain on disposal of \$14,956, net of taxes, for the three months ended March 29, 2013)	—	15,924
Net income (loss)	\$(5,410)	\$6,421
Basic net income (loss) per share from:		
Continuing operations	\$(0.06)	\$(0.08)
Discontinued operations	\$—	\$0.14
Net income (loss)	\$(0.06)	\$0.06
Diluted net income (loss) per share from:		
Continuing operations	\$(0.06)	\$(0.08)
Discontinued operations	\$—	\$0.14
Net income (loss)	\$(0.06)	\$0.06
Shares used in per share calculation:		
Basic	97,921	115,219
Diluted	97,921	115,219

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

Table of Contents

HARMONIC INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (UNAUDITED)

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands)	
Net income (loss)	\$ (5,410 )	\$ 6,421
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	40	(624 )
Gain on investments	7	5
Other comprehensive income (loss) before tax	47	(619 )
Income tax benefit related to items of other comprehensive income (loss)	(1 )	(3 )
Other comprehensive income (loss), net of tax	48	(616 )
Comprehensive income (loss)	\$ (5,362 )	\$ 5,805

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

Table of Contents

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

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$(5,410	) \$6,421
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of intangibles	6,666	7,033
Depreciation	4,227	4,040
Stock-based compensation	3,807	3,986
Gain on sale of discontinued operations, net of tax	—	(14,956
Loss on impairment of fixed assets	—	101
Deferred income taxes	3,510	(204
Provision for excess and obsolete inventories	722	567
Allowance for doubtful accounts, returns and discounts	(536	) 1,116
Excess tax benefits from stock-based compensation	(185	) —
Other non-cash adjustments, net	462	408
Changes in assets and liabilities:		
Accounts receivable	(1,927	) (10,888
Inventories	5,900	6,832
Prepaid expenses and other assets	(6,671	) (8,597
Accounts payable	(2,533	) (2,796
Deferred revenue	6,382	2,667
Income taxes payable	278	(1,257
Accrued and other liabilities	(3,447	) (216
Net cash provided by (used in) operating activities	11,245	(5,743
Cash flows from investing activities:		
Purchases of investments	(14,084	) (25,908
Proceeds from maturities of investments	15,382	16,249
Proceeds from sales of investments	—	4,000
Purchases of property and equipment	(3,431	) (4,274
Proceeds from sale of discontinued operations, net of selling costs	—	44,336
Net cash (used in) provided by investing activities	(2,133	) 34,403
Cash flows from financing activities:		
Payments for repurchase of common stock	(29,075	) (9,268
Proceeds from (repurchases of) common stock issued to employees	(1,377	) 2,508
Excess tax benefits from stock-based compensation	185	—
Net cash used in financing activities	(30,267	) (6,760
Effect of exchange rate changes on cash and cash equivalents	18	(106
Net (decrease) increase in cash and cash equivalents	(21,137	) 21,794
Cash and cash equivalents at beginning of period	90,329	96,670
Cash and cash equivalents at end of period	\$69,192	\$118,464

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



Table of Contents

HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. ("Harmonic," or the "Company") considers necessary for a fair statement 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 February 28, 2014 ("2013 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, 2014, 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").

Discontinued Operations

In the first quarter of fiscal 2013, the Company completed the sale of its cable access hybrid-fiber coaxial ("HFC") business to Aurora Networks ("Aurora"). The results of operations associated with the cable access HFC business were presented as discontinued operations in its unaudited condensed consolidated financial statements as described in Note 3, "Discontinued Operations". There were no operating activities associated with the cable access HFC business after December 31, 2013. Unless noted otherwise, all discussions herein with respect to the Company's unaudited condensed consolidated financial statements relate to the Company's continuing operations.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of 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 2 to its audited Consolidated Financial Statements included in its 2013 Form 10-K. There have been no significant changes to these policies during the three months ended March 28, 2014.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS



Table of Contents

In March 2013, the FASB issued ASU 2013-05, “Parent’s Accounting for the Cumulative Translation Adjustment upon De-recognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity”. The ASU addresses accounting for a cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The new guidance became effective for the Company beginning in the first quarter of fiscal 2014 and it did not have a material impact on the Company’s Consolidated Financial Statements.

In July 2013, the FASB issued ASU 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists”. Under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The new guidance became effective for the Company beginning in the first quarter of fiscal 2014 and it did not have a material impact on the Company’s Consolidated Financial Statements.

On April 10, 2014, the FASB issued ASU 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This guidance raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The guidance is effective for the Company beginning in the first quarter of fiscal 2015. The Company does not expect the adoption of ASU 2014-08 will have a material impact on its financial position, results of operations or cash flows.

**NOTE 3: DISCONTINUED OPERATIONS**

In February 2013, the Company entered into an Asset Purchase Agreement with Aurora pursuant to which the Company agreed to sell its cable access HFC business for \$46.0 million in cash. On March 5, 2013, the sale transaction closed and the Company received gross proceeds of \$46.0 million from the sale and recorded a net gain of \$15.0 million in connection with the sale in the first quarter of fiscal 2013. The gain was included in income from discontinued operations, net of tax in the Condensed Consolidated Statement of Operations for the three months ended March 29, 2013.

In March 2013, the Company entered into a transition services agreement (“TSA”) with Aurora to provide contract manufacturing and other various support, including providing order fulfillment, taking warranty calls, attending to product returns from customers, providing cost accounting analysis, receiving payments from customers and remitting such payments to Aurora. The TSA fees were a fixed amount per month and were determined based on the Company’s estimated cost of delivering the transition services. In addition, in April 2013, the Company and Aurora signed a sublease agreement for the Company’s Milpitas warehouse for the remaining period of the lease.

The TSA ended in October 2013 and the billing to Aurora was recorded in the Condensed Consolidated Statements of Operations under income from continuing operations as an offset to the expenses incurred to deliver the transition services. The table below provides details on the income statement caption under which the TSA billing was recorded (in thousands):

	Three months ended March 29, 2013
Product cost of revenue	\$175
Research and development	9
Selling, general and administrative	144
Total TSA billing to Aurora	\$328
The Company recorded a gain of \$15.0 million in the three months ended March 29, 2013, in connection with the sale of the cable access HFC business, calculated as follows (in thousands):	
Gross Proceeds	\$46,000
Less : Carrying value of net assets	

Edgar Filing: HARMONIC INC - Form 10-Q

Inventories, net	\$10,487	
Prepaid expenses and other current assets	612	
Property and equipment, net	1,133	
Goodwill de-recognized	14,547	
Deferred revenue	(4,499	)
Accrued liabilities	(939	)
Total net assets sold and de-recognized		\$21,341
Less : Selling cost		\$2,469
Less : Tax effect		\$7,234
Gain on disposal, net of taxes		\$14,956

Since the Company has one reporting unit, upon the sale of the cable access HFC business, approximately \$14.5 million of the carrying value of goodwill was allocated to the cable access HFC business based on the relative fair value of the cable access HFC business to the fair value of the Company. The remaining carrying value of goodwill was tested for impairment, and the Company determined that goodwill was not impaired as of March 29, 2013. The results of operations associated with the cable access HFC business are presented as discontinued operations in the Company's Condensed Consolidated Statements of Operations for fiscal 2013. There were no operating activities associated with the cable access HFC business after December 31, 2013. Revenue and the components of net income related to the discontinued operations for the three months ended March 29, 2013 were as follows:

Table of Contents

	Three months ended March 29, 2013
Revenue	\$9,556
Operating income	\$834
Less : (Benefit from) income taxes	(134 )
Add : Gain on disposal, net of taxes	14,956
Income from discontinued operations, net of taxes	\$15,924

## NOTE 4: SHORT-TERM INVESTMENTS

The following table summarizes the Company's short-term investments (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of March 28, 2014				
State, municipal and local government agencies bonds	\$38,754	\$48	\$(17 )	\$38,785
Corporate bonds	30,455	15	(4 )	30,466
Commercial paper	5,291	—	—	5,291
U.S. federal government bonds	4,001	4	—	4,005
Total short-term investments	\$78,501	\$67	\$(21 )	\$78,547
As of December 31, 2013				
State, municipal and local government agencies bonds	\$40,426	\$38	\$(15 )	\$40,449
Corporate bonds	33,483	20	(7 )	33,496
Commercial paper	2,299	—	—	2,299
U.S. federal government bonds	4,004	4	—	4,008
Total short-term investments	\$80,212	\$62	\$(22 )	\$80,252

The following table summarizes the maturities of the Company's short-term investments (in thousands):

	March 28, 2014	December 31, 2013
Less than one year	\$56,494	\$55,278
Due in 1 - 2 years	22,053	24,974
Total short-term investments	\$78,547	\$80,252

Realized gains and losses from the sale of investments for the three months ended March 28, 2014 and March 29, 2013 were not material.

## Impairment of Investments

The Company 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. A decline of fair value below amortized costs of debt securities is considered other-than-temporary if the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of the entire amortized cost basis. 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 its evaluation of available evidence as of March 28, 2014.

As of March 28, 2014, 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.



Table of Contents

**NOTE 5: FAIR VALUE MEASUREMENTS**

The applicable accounting guidance establishes a framework for measuring fair value and requires 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. The forward exchange contracts are classified as Level 2 because they are valued using quoted market prices and other observable data for similar instruments in an active market.

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 March 28, 2014, 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 and liabilities measured at fair value based on the three-tier fair value hierarchy (in thousands):

	Level 1	Level 2	Level 3	Total
As of March 28, 2014				
Cash equivalents				
Money market funds	\$25,814	\$—	\$—	\$25,814
Short-term investments				
State, municipal and local government agencies bonds	—	38,785	—	38,785
Corporate bonds	—	30,466	—	30,466
Commercial paper	—	5,291	—	5,291
U.S. federal government bonds	4,005	—	—	4,005
Prepays and other current assets				
Derivative assets <sup>(1)</sup>	—	19	—	19
Total assets measured and recorded at fair value	\$29,819	\$74,561	\$—	\$104,380
Accrued liabilities				
Derivative liabilities <sup>(1)</sup>	\$—	\$215	\$—	\$215
Total liabilities measured and recorded at fair value	\$—	\$215	\$—	\$215
	Level 1	Level 2	Level 3	Total
As of December 31, 2013				
Cash equivalents				
Money market funds	\$51,014	\$—	\$—	\$51,014
Short-term investments				
State, municipal and local government agencies bonds	—	40,449	—	40,449
Corporate bonds	—	33,496	—	33,496
Commercial paper	—	2,299	—	2,299
U.S. federal government bonds	4,008	—	—	4,008
Prepays and other current assets				
Derivative assets <sup>(1)</sup>	—	196	—	196
Total assets measured and recorded at fair value	\$55,022	\$76,440	\$—	\$131,462
Accrued liabilities				
Derivative liabilities <sup>(1)</sup>	\$—	\$195	\$—	\$195
Total liabilities measured and recorded at fair value	\$—	\$195	\$—	\$195

(1) Derivative assets and liabilities represent forward currency exchange contracts. The Company enters into these contracts to minimize the short-term impact of foreign currency exchange rates fluctuations primarily from trade and inter-company receivables and payables.

## NOTE 6: BALANCE SHEET COMPONENTS

The following tables provide details of selected balance sheet components (in thousands):

	March 28, 2014	December 31, 2013
Accounts receivable, net:		
Accounts receivable	\$84,421	\$83,266
Less: allowances for doubtful accounts, returns and discounts	(6,906	) (8,214
Accounts receivable, net	\$77,515	\$75,052

Table of Contents

Inventories:			
Raw materials		\$2,174	\$2,389
Work-in-process		1,169	976
Finished goods		26,961	33,561
		\$30,304	\$36,926
Property and equipment, net:			
Furniture and fixtures		\$8,222	\$8,227
Machinery and equipment		116,079	114,178
Leasehold improvements		8,170	7,888
Property and equipment, gross		132,471	130,293
Less: accumulated depreciation and amortization		(98,368	) (95,348
		\$34,103	\$34,945

## NOTE 7: GOODWILL AND IDENTIFIED INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the three months ended March 28, 2014 are as follows (in thousands):

Balance at beginning of period	\$198,022
Foreign currency translation adjustment	14
Balance at end of period	\$198,036

The following is a summary of identified intangible assets (in thousands):

	Range of Useful Lives	March 28, 2014			December 31, 2013		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identifiable intangibles:							
Developed core technology	4-6 years	\$136,145	\$(126,397)	\$9,748	\$136,145	\$(121,681)	\$14,464
Customer relationships/contracts	5-6 years	67,098	(55,134)	11,964	67,098	(53,772)	13,326
Trademarks and tradenames	4-5 years	11,361	(10,902)	459	11,361	(10,565)	796
Maintenance agreements and related relationships	6-7 years	7,100	(4,818)	2,282	7,100	(4,567)	2,533
Total identifiable intangibles		\$221,704	\$(197,251)	\$24,453	\$221,704	\$(190,585)	\$31,119

Amortization expense for the identifiable purchased intangible assets for the three months ended March 28, 2014 and March 29, 2013 was allocated as follows (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Included in cost of revenue	\$4,716	\$4,945
Included in operating expenses	1,950	2,088
Total amortization expense	\$6,666	\$7,033

The estimated future amortization expense of purchased intangible assets with definite lives is as follows (in thousands):





Table of Contents

	Cost of Revenue	Operating Expenses	Total
Year ended December 31,			
2014 (remaining 9 months)	\$9,029	\$4,825	\$13,854
2015	719	5,783	6,502
2016	—	4,097	4,097
2017	—	—	—
2018	—	—	—
Total future amortization expense	\$9,748	\$14,705	\$24,453

**NOTE 8: RESTRUCTURING AND RELATED CHARGES****Harmonic 2013 Restructuring**

In the first quarter of fiscal 2013, the Company committed to a restructuring plan to reduce costs and improve efficiencies. This restructuring plan extended to actions taken through the first quarter of fiscal 2014. In fiscal 2013, the Company recorded \$2.2 million of restructuring charges under this plan consisting of worldwide workforce reductions, writing down leasehold improvements and furniture related to its Milpitas warehouse to estimated net realizable value, and obsolete inventory at its Israel facilities. The restructuring charges were included in "Product cost of revenue" and "Operating expenses-restructuring and related charges" in the Condensed Consolidated Statements of Operations. Of the \$2.2 million restructuring charges in fiscal 2013, \$565,000 was recorded in the three months ended March 29, 2013. For a complete discussion of the restructuring actions related to the 2013 restructuring plan, please refer to Note 9 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

The restructuring charges in the three months ended March 28, 2014 were \$228,000 under this plan, of which \$79,000 is included in "Product cost of revenue" and \$149,000 is included in "Operating expenses-restructuring and related charges" in the Consolidated Statements of Operations. The restructuring charges consisted of severance and benefits related to the termination of eight employees worldwide and costs associated with vacating from excess facility in France. The following table summarizes the activity in the restructuring accrual during the three months ended March 28, 2014 (in thousands):

	Severance	Excess facilities	Total
Balance at December 31, 2013	\$179	\$—	\$179
Restructuring charges in continuing operations	196	32	228
Cash payments	(274)	—	(274)
Balance at March 28, 2014	\$101	\$32	\$133

The Company anticipates that the remaining restructuring accrual balance of \$133,000 will be substantially paid out by the second quarter of fiscal 2014.

**HFC Restructuring**

As a result of the sale of the cable access HFC business in March 2013, the Company recorded \$600,000 of restructuring charges under "Income from discontinued operations" in fiscal 2013 consisting of severance and benefits and contract termination costs. For a complete discussion of the restructuring actions related to the HFC restructuring plan, please refer to Note 9 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

The remaining restructuring accrual balance of \$13,000 as of December 31, 2013 was fully paid in the first quarter of fiscal 2014.

**NOTE 9: CREDIT FACILITIES**



Table of Contents

Harmonic has a bank line of credit facility with Silicon Valley Bank that provides for borrowings of up to \$10.0 million and matures on August 22, 2014. There were no borrowings during the three months ended March 28, 2014. As of March 28, 2014, the amount available for borrowing under this facility, net of \$0.2 million of standby letters of credit, was \$9.8 million.

This facility, which became effective in August 2011 and was amended in August 2012, contains a financial covenant that requires Harmonic to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of March 28, 2014, the Company's ratio under that covenant was 4.33 to 1. In the event of noncompliance by Harmonic with the covenants under the facility, including the financial covenant referenced above, Silicon Valley Bank would be entitled to exercise its remedies under the facility, including declaring all obligations immediately due and payable. As of March 28, 2014, Harmonic was in compliance with the covenants under the line of credit facility. Borrowings pursuant to the line would bear interest at the bank's prime rate (3.25% at March 28, 2014,) or at LIBOR for the desired borrowing period (an annualized rate of 0.15% for a one month borrowing period at March 28, 2014) plus 1.75%, or 1.90%. Borrowings are not collateralized.

**NOTE 10: EMPLOYEE BENEFIT PLANS**

Harmonic grants stock options and restricted stock units ("RSUs") pursuant to stockholder approved equity incentive plans. These equity incentive plans are described in detail in Note 12, "Employee Benefit Plans", of Notes to Consolidated Financial Statements in the 2013 Form 10-K

**Stock Options and Restricted Stock Units**

The following table summarizes the Company's stock option and RSU unit activity during the three months ended March 28, 2014 (in thousands, except per share amounts):

	Stock Options Outstanding			Restricted Stock Units Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Number of Units	Weighted Average Grant Date Fair Value
Balance at December 31, 2013	8,752	7,885	\$6.92	3,018	\$ 6.34
Authorized	—	—	—	—	—
Granted	(3,060	) 1,344	6.49	1,144	6.51
Options exercised	—	(56	) 4.34	—	—
Shares released	—	—	—	(871	) 6.19
Forfeited or cancelled	310	(398	) 8.83	(66	) 6.14
Balance at March 28, 2014	6,002	8,775	\$6.78	3,225	\$ 6.45

The following table summarizes information about stock options outstanding as of March 28, 2014 (in thousands, except per share amounts):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Vested and expected to vest	8,315	\$6.81	3.6	\$5,700
Exercisable	5,597	7.05	2.4	3,790

The intrinsic value of options vested and expected to vest and exercisable as of March 28, 2014 is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of March 28, 2014. The intrinsic value of options exercised during the three months ended March 28, 2014 and March 29, 2013 was \$0.1 million and \$0.5 million, respectively.

The following table summarizes information about restricted stock units outstanding as of March 28, 2014 (in thousands, except per share amounts):



Table of Contents

	Number of Shares Underlying Restricted Stock Units	Weighted Average Remaining Vesting Period (Years)	Aggregate Fair Value
Vested and expected to vest	2,917	0.9	\$ 19,955

The fair value of restricted stock units vested and expected to vest of March 28, 2014 is calculated based on the fair value of the Company's common stock as of March 28, 2014.

**Employee Stock Purchase Plan**

The 2002 Employee Stock Purchase Plan ("ESPP") provides for the issuance of common stock purchase rights to employees of the Company. The ESPP is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code. The ESPP enables employees to purchase shares at 85% of the fair market value of the common stock at the beginning or end of the 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. Employees may participate through payroll deductions of 1% to 10% of their earnings. In the event that there are insufficient shares in the plan to fully fund the issuance, the available shares will be allocated across all participants based on their contributions relative to the total contributions received for the offering period.

There was a shortage of approved shares in the ESPP to fund the total employee contributions from January 2, 2013 to June 30, 2013. The shares available in the plan were sufficient to fund approximately 53% of the total contributions. As a result, the shares available were issued ratably to the participants based on each of their contributions during the offering period, relative to the total contributions received from all participants. The participants were refunded the remaining 47% of their contributions and the ESPP was suspended for the second half of 2013. The Company's stockholders approved a 1,000,000 share increase in the authorized shares for the ESPP during the Company's annual meeting on August 14, 2013, and contributions under the ESPP resumed in January 2014.

**401(k) Plan**

Harmonic has a retirement/savings plan which qualifies as a thrift plan under Section 401(k) of the Internal Revenue Code. This plan allows participants to contribute up to the applicable Internal Revenue Code limitations under the plan. Harmonic has made 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. Harmonic contributed \$173,000 for both the three months ended March 28, 2014 and March 29, 2013.

**NOTE 11: STOCK-BASED COMPENSATION**

Stock-based compensation expense consists primarily of expenses for stock options and restricted stock units granted to employees and shares issued under the ESPP. The following table summarizes stock-based compensation expense (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Stock-based compensation in:		
Cost of revenue	\$516	\$611
Research and development expense	1,101	1,203
Selling, general and administrative expense	2,190	2,085
Total stock-based compensation in operating expense	3,291	3,288
Total stock-based compensation	\$3,807	\$3,899

**Stock Options**

The Company estimated the fair value of all employee stock options using a Black-Scholes valuation model with the following weighted average assumptions:



Table of Contents

	Three months ended			
	March 28, 2014	March 29, 2013		
Expected term (years)	4.70	4.70		
Volatility	40	% 52		%
Risk-free interest rate	1.7	% 0.8		%
Expected dividends	0.0	% 0.0		%

The expected term represents the weighted-average period that the stock options are expected to remain outstanding. The computation of the expected term 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. The Company uses its historical volatility for a period equivalent to the expected term of the options to estimate the expected volatility. The risk-free interest rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

The weighted-average fair value per share of options granted was \$2.35 and \$2.50 for the three months ended March 28, 2014 and March 29, 2013, respectively.

The fair value of all stock options vested during the three months ended March 28, 2014 and March 29, 2013 was \$1,330,000 and \$1,260,000, respectively.

The total realized tax benefit attributable to stock options exercised during the three months ended March 28, 2014, in jurisdictions where this expense is deductible for tax purposes, was \$185,000. The Company did not recognize any tax benefit attributable to stock options exercised during the three months ended March 29, 2013.

**Restricted Stock Units**

The estimated fair value of all restricted stock units issued during the three months ended March 28, 2014 and March 29, 2013 was \$5.4 million and \$5.6 million, respectively.

**Employee Stock Purchase Plan**

The value of the stock purchase rights under the ESPP consists of: (1) the 15% discount on the purchase of the stock; (2) 85% of the fair value of the call option; and (3) 15% of the fair value of the put option. The call option and put option were valued using the Black-Scholes option pricing model. The weighted average fair value of the Company's ESPP shares at purchase dates was estimated using the following weighted average assumptions during the three months ended March 28, 2014 and March 29, 2013:

	Purchase Period Ending			
	June 30, 2014	June 30, 2013		
Expected term (years)	0.50	0.49		
Volatility	29	% 32		%
Risk-free interest rate	0.1	% 0.2		%
Expected dividends	0.0	% 0.0		%
Estimated weighted average fair value per share at purchase date	\$1.71	\$1.20		

The expected term represents the period of time from the beginning of the offering period to the purchase date. The Company uses its historical volatility for a period equivalent to the expected term of the options to estimate the expected volatility. The risk-free interest rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term. The Company has never declared or paid any cash dividends





Table of Contents

and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

The ESPP was suspended for the second half of 2013 due to all authorized shares under the plan having been issued through the offering period ended June 30, 2013. The Company's stockholders approved a 1,000,000 share increase in the authorized shares for the ESPP during the Company's annual meeting on August 14, 2013, and contributions under the ESPP resumed in January 2014. As a result, the Company did not have any stock-based compensation expense in the second half of fiscal 2013 related to the ESPP.

#### Unrecognized Stock-Based Compensation

As of March 28, 2014, total unamortized stock-based compensation cost related to unvested stock options and restricted stock units was \$23.9 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.0 years.

#### NOTE 12: INCOME TAXES

The Company reported the following operating results for the periods presented (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Loss from continuing operations before income taxes	\$(7,133 )	\$(14,970 )
Benefit from income taxes	\$(1,723 )	\$(5,467 )
Effective income tax rate	24.2 %	36.5 %

The Company's quarterly income taxes reflect an estimate of the corresponding fiscal year's annual effective tax rate and include, where applicable, adjustments for discrete tax items. In the three months ended March 28, 2014, the Company's effective income tax rate was 24.2% as compared to 36.5% in the corresponding period of 2013, primarily due to the change in the mix of pretax income and losses in the various tax jurisdictions in which the Company operates.

The Company's effective rate for the three months ended March 28, 2014 is lower than the U.S. federal statutory rate of 35% primarily due to favorable tax rates associated with certain earnings from operations in lower-tax jurisdictions, partially offset by the detriment from non-deductible stock-based compensation and non-deductible amortization of foreign intangibles, and the net of various discrete tax adjustments. For the three months ended March 28, 2014, the discrete adjustments to the Company's tax benefit were primarily the accrual of interest on uncertain tax positions. The Company files federal, state, and foreign income tax returns in jurisdictions with varying statutes of limitations during which such tax returns may be audited and adjusted by the relevant tax authorities. The U.S. Internal Revenue Service has concluded its audit for the 2008 and 2009 tax years. In addition, the statute of limitations on the Company's 2008 and 2009 U.S. corporate income tax return expired in September 2013 and, as a result, in the third quarter of 2013, the Company released the related tax reserves, including accrued interest and penalties, for those tax years. The 2010 through 2012 tax years generally remain subject to examination by U.S. federal and most state tax authorities and the statute of limitation for the 2010 tax year will be expiring in September 2014. In significant foreign jurisdictions, the 2006 through 2012 tax years generally remain subject to examination by their respective tax authorities.

The Company's operations in Switzerland are subject to a reduced tax rate under the Switzerland tax holiday which requires various thresholds of investment and employment in Switzerland. The Company has met these various thresholds and the Switzerland tax holiday is effective through the end of 2018.

As of March 28, 2014, the total amount of gross unrecognized tax benefits, including interest and penalties, was approximately \$26.1 million, that if recognized, would affect the Company's effective tax rate. The Company recognizes interest and penalties related to unrecognized tax positions in income tax expense. The Company had \$1.7 million of gross interest and penalties accrued as of March 28, 2014. The Company will continue to review its tax positions and provide for, or reverse, unrecognized tax benefits as issues arise. As of March 28, 2014, the Company anticipates that the balance of gross unrecognized tax benefits will decrease up to approximately \$10 million due to expiration of the applicable statutes of limitations over the next 12 months.

The Company assesses the realizability of its deferred tax assets on a quarterly basis. A valuation allowance may be recorded in the event it is deemed to be more-likely-than-not that the deferred tax asset cannot be realized. The Company believes, based on

17

---

Table of Contents

the quarterly assessment performed at March 28, 2014, that it is possible that a valuation allowance may be required in the future.

**NOTE 13: INCOME (LOSS) PER SHARE**

The following table sets forth the computation of the basic and diluted net loss per share (in thousands, except per share amounts):

	Three months ended	
	March 28, 2014	March 29, 2013
Numerator:		
Loss from continuing operations	\$(5,410	) \$(9,503
Income from discontinued operations	—	15,924
Net income (loss)	\$(5,410	) \$6,421
Denominator:		
Weighted average number of common shares outstanding		
Basic and diluted	97,921	115,219
Basic and diluted net income (loss) per share from:		
Continuing operations	\$(0.06	) \$(0.08
Discontinued operations	\$0.00	\$0.14
Net Income (loss)	\$(0.06	) \$0.06

The following table sets forth the potentially dilutive shares from stock options, restricted stock units and the ESPP, for the periods presented, that were excluded from the net income (loss) per share computations because their effect was anti-dilutive (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Potentially dilutive equity awards outstanding	11,072	13,131

**NOTE 14: COMMITMENTS AND CONTINGENCIES****Leases**

Future minimum lease payments under non-cancelable operating leases as of March 28, 2014, after giving effect to \$0.4 million of future sublease income from Aurora, are as follows (in thousands):

Years ending December 31,	
2014 (remaining nine months)	\$7,264
2015	9,416
2016	8,178
2017	7,703
2018	7,644
Thereafter	13,619
Total	\$53,824

Table of Contents

## 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 warranty claims. Activity for the Company's warranty accrual, which is included in accrued liabilities, is summarized below (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Balance at beginning of period	\$3,606	\$4,292
Transfer to Aurora as part of the sale of discontinued operations	—	(939 )
Accrual for current period warranties	1,749	1,394
Warranty costs incurred	(1,696 )	(1,477 )
Balance at end of period	\$3,659	\$3,270

## Purchase Commitments with Contract Manufacturers and Other Suppliers

The Company relies on a limited number of contract manufacturers and suppliers to provide manufacturing services for a substantial majority of its products. In addition, some components, sub-assemblies and modules are obtained from a sole supplier or limited group of suppliers. During the normal course of business, in order to reduce manufacturing lead times and ensure adequate component supply, the Company enters into agreements with certain contract manufacturers and suppliers that allow them to procure inventory based upon criteria defined by the Company. The Company had approximately \$26.1 million of non-cancelable purchase commitments with contract manufacturers and other suppliers as of March 28, 2014.

## Standby Letters of Credit

As of March 28, 2014, 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 \$0.2 million as of March 28, 2014.

## 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 most of its customers for specified intellectual property 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 these indemnification provisions through March 28, 2014.

## Guarantees

The Company has \$0.5 million of guarantees in Israel as of March 28, 2014, with the majority relating to rent obligations for buildings used by its Israeli subsidiaries.

## Legal proceedings

From time to time, the Company is involved in lawsuits as well as subject to various legal proceedings, claims, threats of litigation, and investigations in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment, and other matters. The Company assesses potential liabilities in connection with each lawsuit and threatened lawsuits and accrues an estimated loss for these loss contingencies if both of the following conditions are met: information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated. While certain matters to which the Company is a party specify the damages claimed, such claims may not represent reasonably possible losses. Given the inherent uncertainties of litigation, the ultimate outcome of these matters cannot be predicted at this time, nor can the amount of possible loss or range of loss, if any, be reasonably estimated.

In October 2011, Avid Technology, Inc. ("Avid") filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic's Media Grid product infringes two patents held by Avid. A jury trial on this complaint commenced on January 23, 2014 and, on February 4, 2014, the jury returned a unanimous verdict in favor of Harmonic, rejecting Avid's infringement allegations in their entirety. Avid has indicated it intends to appeal the verdict.

Table of Contents

In June 2012, Avid served a subsequent complaint in the United States District Court for the District of Delaware alleging that Harmonic's Spectrum product infringes one patent held by Avid. The complaint seeks injunctive relief and unspecified damages. In September 2013, the U.S. Patent Trial and Appeal Board ("PTAB") authorized an inter partes review to be instituted as to claims of the patent asserted in this second complaint. A hearing before the PTAB has been scheduled for May 2014.

An unfavorable outcome on any litigation matter 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 matters referenced above or other litigation matters could have a material adverse effect on Harmonic's business, operating results, financial position and cash flows.

**NOTE 15: STOCKHOLDERS' EQUITY**

## Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss were as follows (in thousands):

	March 28, 2014	December 31, 2013
Foreign currency translation adjustments	\$(202	) \$(242
Unrealized gain on investments	41	33
Accumulated other comprehensive loss	\$(161	) \$(209
Common Stock Repurchases		

On April 24, 2012, our Board of Directors (the "Board") approved a stock repurchase program that provided for the repurchase of up to \$25 million of our outstanding common stock. During 2013, the Board approved \$195 million of increases to the program, increasing the aggregate authorized amount of the program to \$220 million. On February 6, 2013, the Board approved a modification to the program that permits the Company to also repurchase its common stock pursuant to a plan that meets the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934. The repurchase program is scheduled to expire in December 2014.

As of March 28, 2014, we had purchased 27.7 million shares of common stock under this program at a weighted average price of \$6.03 per share for an aggregate purchase price of \$167.3 million, excluding fees. The remaining authorized amount for stock repurchases under this program was \$52.7 million as of March 28, 2014. For addition information, see "Item 2 - Unregistered sales of equity securities and use of proceeds" of this Form 10-Q.

**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 ("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 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," "predicts," "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 and demands in the markets we address, particularly emerging markets;
- economic conditions, particularly in certain geographies, and in financial markets;
- new and future products and services;
- capital spending of our customers;
- our strategic direction, future business plans and growth strategy;



Table of Contents

industry and customer consolidation;  
expected demand for and benefits of our products and services;  
economic conditions, particularly in certain geographies, and in financial markets;  
seasonality of revenue and concentration of revenue sources;  
the potential impact of our continuing stock repurchase plan;  
potential future acquisitions and dispositions;  
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, any of 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

We design, manufacture and sell versatile and high performance video infrastructure products and system solutions that enable our customers to efficiently create, prepare and deliver a full range of video services to consumer devices, including televisions, personal computers, laptops, tablets and smart phones. We sell video processing and production and playout solutions and services worldwide to broadcast and media companies, streaming new media companies, cable operators, and satellite and telecommunications (telco) Pay-TV service providers. We also sell cable edge solutions and related services to cable operators globally.

In the first quarter of fiscal 2013, we completed the sale of our cable access HFC business to Aurora Networks (“Aurora”) for \$46.0 million in cash. The results of operations associated with the cable access HFC business were presented as discontinued operations in our unaudited condensed consolidated financial statements as described in Note 3, “Discontinued Operations”. There were no operating activities associated with the cable access HFC business after December 31, 2013. Unless noted otherwise, all discussions herein with respect to the Company’s unaudited condensed consolidated financial statements relate to the Company’s continuing operations.

Historically, a majority of our revenue has been derived from relatively few customers, due in part to the consolidation of the ownership of cable operators and satellite Pay-TV service providers. Sales to our ten largest customers in the three months ended March 28, 2014 accounted for approximately 47% of our revenue, compared to 35% for the same period in 2013. The increase in the sales to our ten largest customers in the three months ended March 28, 2014, as compared to the same period in 2013, was primarily due to increased cable edge product sales, including our new NSG Pro converged cable access platform (“CCAP”) product. While we continue to seek to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration. During the three months ended March 28, 2014, revenue from Comcast accounted for 20% of our revenue, compared to 9% for the same period in 2013.

In the three months ended March 28, 2014, we recognized revenue of \$108 million compared to \$102 million in the same period in 2013. Our international sales decreased 8% in the three months ended March 28, 2014, as compared to the same period in 2013. Domestic sales increased by 27% in the three months ended March 28, 2014, as compared to the same period in 2013. The increase in our domestic sales in the first quarter of 2014, as compared to the same period in 2013, was primarily driven by increased cable edge product sales in the U.S. and the decrease in our international revenue was primarily due to softer demand in Europe in the first quarter of 2014. We expect that international sales will continue to account for a significant





Table of Contents

portion of our net revenue for the foreseeable future, and expect that, due to sales in emerging markets in particular, our international revenue may increase as a percentage of our total net revenue from year to year.

Historically, our revenue has been dependent upon capital spending in the cable, satellite, telco and broadcast industries. More recently, we also have derived revenue from media companies, including streaming media providers. Industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. 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 we attempt to further diversify our customer base in these markets, we may need to continue to build alliances with other equipment manufacturers and content providers, adapt our products for new applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the media market, which could result in higher operating costs. Implementation issues with our products or those of other vendors have caused in the past, and may cause in the future, delays in project completion for our customers and delay our recognition of revenue.

Our quarterly revenue has been, and may continue to be, affected by seasonal buying patterns. Typically, revenue in the first quarter of the year is seasonally lower than other quarters, as our customers often are still finalizing their annual budget and capital spending projections for the year. Further, we often recognize a substantial portion of our quarterly revenues in the last month of each 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.

As part of our business strategy, (1) from time to time we have acquired, and continue to consider acquiring, businesses, technologies, assets and product lines that we believe complement or may expand our existing business, and (2) from time to time we consider divesting a product line that we believe may no longer complement or expand our existing business. In September 2010, we completed the acquisition of Omneon, Inc., a 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. Omneon's business was complementary to Harmonic's core business, and expanded our customer reach into content providers and extended our product lines into video servers and video-optimized storage for content production and playout. In March 2013, we sold our cable access HFC business to Aurora Networks. See Note 3, "Discontinued Operations" of our Condensed Consolidated Financial Statements.

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

There have been no material changes to our critical accounting policies, judgments and estimates, during the three months ended March 28, 2014, from those disclosed in our 2013 Form 10-K.

**RESULTS OF OPERATIONS**

Net Revenue

Net Revenue by Product Line

Harmonic's consolidated net revenue, by product line, for the three months ended March 28, 2014, compared to the same period in 2013, are presented in the table below. Also presented are the related dollar and percentage change in consolidated net revenue, by product line, in the three months ended March 28, 2014, as compared to the same period in 2013.

Table of Contents

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands, except percentages)	
Revenue by type:		
Video processing products	\$46,683	\$42,906
Production and playout products	17,335	\$22,230
Cable edge products	24,242	\$17,339
Service and support	19,772	\$19,197
Net revenue	\$108,032	\$101,672
Increase (Decrease):		
Video processing products	\$3,777	
Production and playout products	(4,895	)
Cable edge products	6,903	
Service and support	575	
Total increase	\$6,360	
Percent change:		
Video processing products	9	%
Production and playout products	(22	)%
Cable edge products	40	%
Service and support	3	%
Total percent change	6	%

The 9% increase in our video processing revenue in the three months ended March 28, 2014, compared to the same period in 2013, was primarily a result of our efforts in developing industry leading compression technologies as some satellite direct-to-home and telco Pay-TV service providers appear to be refreshing their encoding base with our improved encoders. The 22% decrease in our production and playout revenue in the three months ended March 28, 2014, compared to the same period in 2013 was primarily a result of the softness in demand in the European region in the first quarter of 2014. The 40% increase in our cable edge revenue in the three months ended March 28, 2014, compared to the same period in 2013, was primarily related to our NSG products, including the new NSG Pro CCAP-enabled product that was launched in the fourth quarter of 2013. The 3% increase in our service and support revenues in the three months ended March 28, 2014, compared to the same period in 2013, was mainly driven by increased maintenance revenues across all regions, offset partially by a decrease in revenue from professional and integration services.

#### Net Revenue by Geographic Region

Harmonic's domestic and international net revenue in the three months ended March 28, 2014, compared with the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage change in domestic and international net revenue, in the three months ended March 28, 2014, from the corresponding period in 2013.

Table of Contents

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands, except percentages)	
Net revenue:		
United States	\$53,625	\$42,350
International	54,407	59,322
Total	\$108,032	\$101,672
Increase (Decrease):		
United States	\$11,275	
International	(4,915	)
Total increase	\$6,360	
Percent change:		
United States	27	%
International	(8	)%
Total percent change	6	%

U.S. net revenue increased 27% in the three months ended March 28, 2014, compared to the same period in 2013 primarily due to increased sales of our video processing products in the satellite and telco market and increased sales of our cable edge products, including our new NSG Pro CCAP-enabled product to the U.S. cable operators. It appears that some of these providers and operators have been looking ahead to the availability of new technologies since early 2013 and are making plans in 2014 to transition to a more flexible, all-IP, converged video and data access network. International net revenue decreased 8% in the three months ended March 28, 2014, compared to the same period in 2013, primarily due to decreased revenue in the Europe, Middle East and Africa ("EMEA") region, offset partially by increased revenue in the Central and Latin America ("CALA") region. The decrease in EMEA net revenue in the three months ended March 28, 2014, compared to the same period in 2013, was primarily due to softer demand in Europe for all of our products. The increase in CALA net revenue in the three months ended March 28, 2014, compared to the same period in 2013, was primarily driven by increased sales of our video processing products to emerging markets.

**Gross Profit**

Harmonic's gross profit and gross profit as a percentage of net revenue ("gross margin"), in the three months ended March 28, 2014, as compared to the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage changes in gross profit in the three months ended March 28, 2014, from the corresponding period in 2013.

	Three months ended	
	March 28, 2014	March 29, 2013
	(In thousands, except percentages)	
Gross profit	\$52,312	\$46,165
As a percentage of net revenue ("gross margin")	48.4	% 45.4
Increase	\$6,147	
Percent change	13	%

Our gross margins are dependent upon, among other factors, achievement of cost reductions, product mix, customer mix, product introduction costs, and price reductions granted to customers. Gross margin was 48.4% in the three months ended March 28, 2014, compared to 45.4% in the corresponding period in 2013. This 3.0% increase in gross margin was primarily due to a more favorable customer mix and an increase in license sales into our existing hardware customers as well as operational efficiencies as a result of our various cost reduction initiatives.

In the three months ended March 28, 2014, \$4.7 million of amortization of intangibles was included in cost of revenue, compared to \$4.9 million in the corresponding period in 2013.

Table of Contents

## Research and Development

Harmonic's research and development expense consists primarily of employee salaries, related expenses, contractors and outside consultants, supplies and materials, equipment depreciation and facilities costs, all associated with the design and development of new products and enhancements of existing products. Harmonic's research and development expense and the expense as a percentage of net revenue, in the three months ended March 28, 2014, as compared with the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage changes in research and development expense in the three months ended March 28, 2014, from the corresponding period in 2013.

	Three months ended			
	March 28, 2014	March 29, 2013		
	(In thousands, except percentages)			
Research and development	\$23,888	\$25,251		
As a percentage of net revenue	22	% 25	%	
Decrease	\$(1,363	)		
Percent change	(5	)%		

Research and development expenses as a percentage of net revenue decreased from 25% in the three months ended March 29, 2013 to 22% in the three months ended March 28, 2014. The \$1.4 million or 5% decrease in research and development expenses in the three months ended March 28, 2014, compared to the corresponding period of 2013, was primarily due to decreased employee compensation expense of \$2.0 million and decreased prototype materials costs of \$0.3 million. The decrease in employee compensation expense was mainly due to headcount reduction and a decrease in accrual for employee time off benefits. Effective April 1, 2013, the Company implemented a new program which no longer requires the accrual of employee time off benefits in the U.S. These decreases in research and development expenses in the three months ended March 28, 2014 were offset partially by increased expenses on consulting and outside engineering services of \$1.0 million.

## Selling, General and Administrative

Harmonic's selling, general and administrative expense, and the expense as a percentage of net revenue, in the three months ended March 28, 2014, as compared with the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage change in selling, general and administrative expense in the three months ended March 28, 2014, from the corresponding period in 2013.

	Three months ended			
	March 28, 2014	March 29, 2013		
	(In thousands, except percentages)			
Selling, general and administrative	\$33,547	\$33,269		
As a percentage of net revenue	31	% 33	%	
Increase	\$278			
Percent change	1	%		

The 1% increase in selling, general and administrative expenses in the three months ended March 28, 2014, compared to the corresponding period of 2013, was primarily the result of increased facilities rental and operating expenses of \$0.5 million in the U.S. as well as in the Asia region, increased trade show and marketing expenses of \$0.2 million, offset partially by decreased expenses in legal, accounting and tax planning consultation services, aggregating \$0.6 million.

## Amortization of Intangibles

Harmonic's amortization of intangible assets charged to operating expenses, and the amortization of intangible assets as a percentage of net revenue, in the three months ended March 28, 2014, as compared with the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage changes in amortization of intangible assets in the three months ended March 28, 2014, from the corresponding period in 2013.



Table of Contents

	Three months ended			
	March 28, 2014	March 29, 2013		
	(In thousands, except percentages)			
Amortization of intangibles	\$1,950	\$2,088		
As a percentage of net revenue	2	% 2		%
Decrease	\$(138	)		
Percent change	(7	)%		

The decrease in amortization of intangibles expense in the three months ended March 28, 2014, compared to the corresponding period in 2013, was primarily due to certain purchased intangible assets becoming fully amortized.

**Restructuring and Related Charges**

In the first quarter of fiscal 2013, the Company committed to a restructuring plan to reduce costs and improve efficiencies. This restructuring plan extended to actions taken through the first quarter of fiscal 2014.

Restructuring charges in the three months ended March 28, 2014 were \$228,000 under this plan, of which \$79,000 is included in "Product cost of revenue" and \$149,000 is included in "Operating expenses-restructuring and related charges" in the Consolidated Statements of Operations. The restructuring charges consisted of severance and benefits related to the termination of eight employees worldwide and costs associated with vacating from an excess facility in France.

Restructuring charges in the three months ended March 29, 2013 was \$565,000 under this plan, of which \$141,000 is included in "Product cost of revenue" and \$424,000 is included in "Operating expenses-restructuring and related charges" in the Condensed Consolidated Statements of Operations. The restructuring charges consisted of severance and benefits related to the termination of thirty employees worldwide and costs associated with writing down warehouse leasehold improvements to estimated net realizable value.

**Interest Income, Net**

Interest income, net remained relatively flat at \$77,000 and \$64,000 in the three months ended March 28, 2014 and March 29, 2013, respectively.

**Other Income (Expense), Net**

In the three months ended March 28, 2014 and March 29, 2013, other income (expense), net was \$12,000 and \$(167,000), respectively. Other income (expense), net is primarily comprised of foreign exchange gains and losses on cash, accounts receivable and inter-company balances denominated in currencies other than the U.S dollar. To mitigate the volatility related to fluctuations in foreign exchange rates, the Company may enter into various foreign currency forward contracts. The gain (loss) on foreign currency is driven by the fluctuations in the foreign currency exchange rates, primarily the Euro, British pound, Japanese yen and Israeli shekels.

**Income Taxes**

Harmonic's benefit from income taxes as a percentage of net revenue, in the three months ended March 28, 2014, as compared with the corresponding period in 2013, are presented in the table below. Also presented are the related dollar and percentage changes in benefit from income taxes in the three months ended March 28, 2014, from the corresponding period in 2013.

	Three months ended			
	March 28, 2014	March 29, 2013		
	(In thousands, except percentages)			
Benefit from provision for income taxes	\$(1,723	)	\$(5,467	)
As a percentage of net revenue	(2	)%	(5	)%
Decrease in benefit from income taxes	\$3,744			
Percent change	(68	)%		

Harmonic operates in multiple jurisdictions and its profits are taxed pursuant to the tax laws of these jurisdictions. Our effective income tax rate may be affected by changes in or interpretations of tax laws and tax agreements in any given jurisdiction, utilization of net operating loss and tax credit carry forwards, changes in geographical mix of income and expense, and changes





## Table of Contents

in management's assessment of matters such as the ability to realize deferred tax assets, as well as recognition of uncertain tax benefits or the effects of statute of limitation, or settlement with tax authorities.

The Company's quarterly income taxes reflect an estimate of the corresponding fiscal year's annual effective tax rate and include, where applicable, adjustments for discrete tax items. In the three months ended March 28, 2014, the Company's effective income tax rate was 24.2% as compared to 36.5% in the corresponding period of 2013, primarily due to the change in the mix of pretax income and losses in the various tax jurisdictions in which the Company operates.

The Company's effective rate for the three months ended March 28, 2014 is lower than the U.S. federal statutory rate of 35% primarily due to favorable tax rates associated with certain earnings from operations in lower-tax jurisdictions, partially offset by the detriment from non-deductible stock-based compensation and non-deductible amortization of foreign intangibles, and the net of various discrete tax adjustments. For the three months ended March 28, 2014, the discrete adjustments to the Company's tax benefit were primarily the accrual of interest on uncertain tax positions.

### Discontinued Operations

In the first quarter of fiscal 2013, the Company completed the sale of its cable access HFC business to Aurora Networks ("Aurora"). The results of operations associated with the cable access HFC business were presented as discontinued operations in its unaudited condensed consolidated financial statements as described in Note 3, "Discontinued Operations". There were no operating activities associated with the cable access HFC business after December 31, 2013. The income from discontinued operations, net of tax in the three months ended March 29, 2013 was \$15.9 million, including a \$15.0 million net gain in connection with the sale.

### Liquidity and Capital Resources

As of March 28, 2014, our cash and cash equivalents totaled \$69.2 million, and our short-term investments totaled \$78.5 million. As of March 28, 2014, a majority of our cash, cash equivalents and short-term investments were held in accounts in the United States. We believe that these funds are sufficient to meet the requirements of our operations in the next twelve months, as well as any stock repurchases under our present stock repurchase program. In the event that we need funds from our foreign subsidiaries to fund the operations in the U.S., and if U.S. tax has not already been previously provided, we may be required to accrue and pay additional U.S. taxes in order to repatriate these funds. However, our intent is to permanently reinvest these funds outside the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

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 adverse market conditions. Our inability to sell all or a material portion of our short-term investments at par or our cost, or 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.

We have a bank line of credit facility with Silicon Valley Bank that provides for borrowings of up to \$10.0 million and matures on August 22, 2014. As of March 28, 2014, there were no amounts outstanding under the line of credit facility and there were no borrowings during the three months ended March 28, 2014. As of March 28, 2014, the amount available for borrowing under this facility, net of \$0.2 million of standby letters of credit, was \$9.8 million. Future borrowings pursuant to the line would bear interest at the bank's prime rate (3.25% at March 28, 2014) or at LIBOR for the desired borrowing period (an annualized rate of 0.15% for a one month borrowing period at March 28, 2014) plus 1.75%, or 1.90%. Borrowings are not collateralized. This facility contains a financial covenant that requires us to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of March 28, 2014, the ratio under that covenant was 4.33 to 1. In the event of noncompliance by us with the covenants under the facility, including the financial covenant referenced above, Silicon Valley Bank would be entitled to exercise its remedies under the facility, including declaring all obligations immediately due and payable.

From time to time, we may consider 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 opportunities, to develop new products or to otherwise respond to competitive pressures. In addition, 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 any global or regional economic slowdown, market uncertainty surrounding the necessary increases in the U.S. debt limit and its future debt obligations, the impact of increases in oil prices and conditions in financial

Table of Contents

markets and the industries we serve. There can be no assurance that any financing will be available on terms acceptable to us, if at all.

The table below sets forth selected cash flow data for the periods presented (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Net cash provided by (used in):		
Operating activities	\$11,245	\$(5,743 )
Investing activities	(2,133 )	34,403
Financing activities	(30,267 )	(6,760 )
Effect of foreign exchange rate changes on cash	18	(106 )
Net (decrease) increase in cash and cash equivalents	\$(21,137 )	\$21,794
Operating Activities		

Net cash provided by operations in the three months ended March 28, 2014 was \$11.2 million, resulting from a net loss of \$5.4 million, adjusted for \$18.6 million in non-cash gains and charges, and a \$2.0 million decrease in cash associated with the net change in operating assets and liabilities. The non-cash gains and charges primarily included amortization of intangible assets, stock-based compensation, depreciation, adjustments to deferred income taxes, and provisions for excess and obsolete inventories, partially offset by provision for doubtful accounts, returns and discounts. The net change in operating assets and liabilities included increases in prepaid expenses and other assets and accounts receivable, as well as decreases in accrued and other liabilities and accounts payable, which were partially offset by a decrease in inventories, as well as an increase in deferred revenue. The increase in prepaid and other assets was primarily due to the increase in tax receivable resulting from a tax benefit from the loss on continuing operations in the first quarter of fiscal 2014 and the tax effects associated with the write-off of certain fully reserved obsolete inventories, as well as the tax benefits on options exercised in the first quarter of fiscal 2014. The decrease in accrued and other liabilities was primarily due to the bonus payment made in the first quarter of fiscal 2014 and the decrease in inventory was primarily due to our concerted efforts to better optimize our supply chain. The increase in deferred revenue was primarily due to the timing of periodic service and support billings for annual contracts.

Net cash used in operations in the three months ended March 29, 2013 was \$5.7 million, resulting from a net income of \$6.4 million, adjusted for \$2.1 million in non-cash gains and charges and a \$14.2 million decrease in cash associated with the net change in operating assets and liabilities. The non-cash gains and charges primarily included amortization of intangible assets, stock-based compensation, depreciation, and provisions for excess and obsolete inventories, doubtful accounts, returns and discounts, and partially offset by a \$15.0 million gain on disposal of discontinued operations, net of tax and adjustments to deferred income taxes. The net change in operating assets and liabilities included increases in accounts receivable and prepaid expenses and other assets, as well as decreases in accounts payable, income tax payable and accrued and other liabilities, which were offset by decreases in inventories, as well as increases in deferred revenue. The increase in accounts receivable was primarily due to shipments occurring later in the first quarter of 2013 than we experienced in 2012. The increase in prepaid expenses and other assets was primarily due to the increase in benefit from income taxes for the three months ended March 29, 2013, compared to the same period in 2012, due to the reinstatement of the federal R&D tax credit retroactively from January 1, 2012, and an increase in loss from continuing operations in the three months ended March 29, 2013, compared to the same period in 2012. The decrease in accounts payable was primarily due to the timing of payments and lower inventory purchases, and the decrease in inventory was primarily due to lower purchases resulting from the sale of the cable access HFC business.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections performance, inventory and supply chain management, income tax reserves adjustments, and the timing and amount of compensation and other payments. We usually pay our annual incentive compensation to employees in the first quarter.

Investing Activities

Edgar Filing: HARMONIC INC - Form 10-Q

Net cash used in investing activities was \$2.1 million in the three months ended March 28, 2014, resulting from the purchase of short-term investments of \$14.1 million and capital expenditures of \$3.4 million, partially offset by the proceeds from the net sale and maturity of investments of \$15.4 million.

Net cash provided by investing activities was \$34.4 million in the three months ended March 29, 2013, resulting from the net proceeds from the sale of discontinued operations of \$44.3 million and proceeds from the net sale and maturity of short-term

## Table of Contents

investments of \$20.3 million, partially offset by the purchase of short-term investments of \$25.9 million and capital expenditures of \$4.3 million.

### Financing Activities

Net cash used in financing activities was \$30.3 million in the three months ended March 28, 2014, primarily resulting from \$29.1 million of payments for the repurchase of common stock in connection with our stock repurchase program and \$1.4 million of net payments relating to the repurchase of common stock issued to employees to satisfy employee tax withholding obligations that arose on the vesting of shares of restricted stocks units.

Net cash used in financing activities was \$6.8 million in the three months ended March 29, 2013, resulting from \$9.3 million of payments for the repurchase of common stock in connection with our stock repurchase program, partially offset by \$2.5 million of net proceeds from the issuance of common stock related to our equity incentive plans.

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as of March 28, 2014.

### Contractual Obligations and Commitments

As of March 28, 2014, we had approximately \$26.1 million of non-cancelable purchase order commitments. There were no other significant changes to our contractual obligations and commitments in the three months ended March 28, 2014, from such information presented in our 2013 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 held by Harmonic's subsidiaries, and changes in the value of financial instruments held by Harmonic.

### Foreign Currency Exchange Risk

Harmonic operates in international markets, which expose us to market risk associated with foreign currency exchange rate fluctuations between the U.S. Dollar and various foreign currencies.

Harmonic has certain international customers who are billed in their local currency, primarily the Euro, British pound and Japanese yen. Sales denominated in foreign currencies were approximately 11% and 15% of revenue in the first three months of 2014 and 2013, respectively. In addition, a portion of our operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, sales support and research and development, are denominated in foreign currencies, primarily the Israeli shekel, British pound, Euro, Singapore dollar, Chinese yuan and Indian rupee. Given that the operating expenses which we incur in currencies other than U.S. dollars have not been a significant percentage of our revenues, we do not believe that our foreign currency exchange rate fluctuation risk is significant. Consequently, we do not believe that a 10% change in foreign currency exchange rates would have a significant effect on our future net income or cash flows.

The Company enters into foreign currency forward contracts to minimize the short-term impact of foreign currency exchange rate fluctuations on cash and certain trade and inter-company receivables and payables, primarily denominated in Euro, British pound, Japanese yen and Israeli shekel. These contracts reduce the exposure to fluctuations in foreign currency exchange rate movements as the gains and losses associated with foreign currency balances are generally offset with the gains and losses on the forward contracts. These derivative instruments are marked to market through earnings every period and generally range from one to three months in original maturity. We do not enter into foreign currency forward contracts for trading purposes. The notional amounts of our foreign currency forward contracts outstanding at March 28, 2014 are summarized in U.S. dollar equivalents as follows (in thousands):

Table of Contents

	March 28, 2014	December 31, 2013
Forward contracts sold:		
Euro	13,670	14,254
British pound sterling	2,183	2,914
Japanese yen	4,283	3,777
	20,136	20,945
Forward contracts purchased:		
Euro	11,085	6,024
British pound sterling	1,115	2,966
Japanese yen	2,156	1,608
Israeli shekel	5,270	4,441
	19,626	15,039

**Interest rate and credit risk**

Harmonic's exposure to market risk for changes in interest rates relates primarily to our investment portfolio of marketable debt securities of various issuers, types and maturities and to our borrowings under the bank line of credit facility. As of March 28, 2014, our cash, cash equivalents and short-term investments balance was \$147.7 million and we had no borrowings during the first three months ended 2014. Our short-term 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)". For the first three months ended 2014 and 2013, realized gains and realized losses from the sale of investments were not material.

The Company does not use derivative instruments in our investment portfolio and our investment portfolio only includes highly liquid instruments. These instruments, as with all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. Conversely, a decline in interest rates will decrease the interest income from our investment portfolio. The Company attempts to limit this exposure by investing primarily in short-term and investment-grade instruments with original maturities of less than two years.

A sensitivity analysis was performed to determine the impact a change in interest rates would have on the value of our investment portfolio. Based on our investment positions as of March 28, 2014, a hypothetical 100 basis point increase in interest rates would result in a \$0.5 million decline in fair market value of our portfolio. Such losses would only be realized if we sold the investments prior to maturity. A hypothetical decrease in market interest rates by 10% will result in a decline in interest income from our investment portfolio by less than \$0.1 million.

**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 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, and 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.

Table of Contents

Based on their evaluation as of the end of the period covered by this 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.

During the quarterly period covered by this Form 10-Q, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



Table of Contents

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In October 2011, Avid Technology, Inc. ("Avid") filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic's Media Grid product infringes two patents held by Avid. A jury trial on this complaint commenced on January 23, 2014 and, on February 4, 2014, the jury returned a unanimous verdict in favor of Harmonic, rejecting Avid's infringement allegations in their entirety. Avid has indicated it intends to appeal the verdict.

In June 2012, Avid served a subsequent complaint in the United States District Court for the District of Delaware alleging that Harmonic's Spectrum product infringes one patent held by Avid. The complaint seeks injunctive relief and unspecified damages. In September 2013, the U.S. Patent Trial and Appeal Board ("PTAB") authorized an inter partes review to be instituted as to claims of the patent asserted in this second complaint. A hearing before the PTAB has been scheduled for May 2014.

We are subject to other litigation incidental to our business that is not believed to be material to us.

ITEM 1A. RISK FACTORS

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

Our revenue has been derived from worldwide sales to cable operators, satellite and telco Pay-TV service providers and broadcast and media companies, as well as, more recently, emerging streaming media companies. We expect that these markets will provide our revenue for the foreseeable future. Demand for our products will depend on the magnitude and timing of capital spending by customers in each of these markets for the purpose of creating, expanding or upgrading their systems. These capital spending patterns are dependent on a variety of factors, including:

- impact of general economic conditions, actual and projected;
- access to financing;
- annual capital spending budget cycles of each of the industries we serve;
- impact of industry consolidation;
- customers suspending or reducing capital spending in anticipation of the introduction of announced new standards, such as high efficiency video coding (HEVC), and products, such as products based on the (CCAP) architecture;
- federal, state, local and foreign government regulation of telecommunications, television broadcasting and streaming media;
- overall demand for communication services and consumer acceptance of new video and data technologies and services;
- competitive pressures, including pricing pressures; and
- discretionary end-user customer spending patterns.

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

- weak or uncertain economic and financial conditions in the U.S. or one or more international markets;
- uncertainty related to development of digital video industry standards;
- delays in evaluations of new services, new standards and systems architectures by many operators;

32

---

Table of Contents

- emphasis by operators on generating revenue from existing customers, rather than from new customers, through construction, expansion or 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 of each;
- completion of a new system or significant expansion or upgrade to a system; and
- bankruptcies and financial restructuring of major customers.

In the past, adverse economic conditions in one or more of the geographies in which we offer our products have adversely affected our customers' capital spending in those geographies and, as a result, our business. In 2008, 2009 and the first half of 2010, economic conditions in many of the geographies in which we offer our products were 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. Global economic activity and overall economic growth has improved since 2010, although unevenly across geographies.

The severity or length of time that economic and financial market conditions may be weak or sluggish, whether certain or all of such adverse factors will persist, or whether another severe down turn may occur in the U.S., Europe or in other geographies, is unknown. During challenging economic times, and in tight credit markets, many customers may delay or reduce capital expenditures. This could result in reductions in revenue from 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., Europe or other key markets, deteriorate, we could experience a material and adverse effect on our business, results of operations, financial condition and cash flows.

In addition, industry consolidation has in the past constrained, and may in the future constrain or delay, 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 sales prices in the past. Pressure on average sales prices was particularly severe during previous economic downturns, such as in 2008 and 2009, as equipment suppliers competed aggressively for customers' reduced capital spending.

Our competitors in video processing solutions include vertically integrated system suppliers, such as Arris, Cisco Systems and Ericsson, and, in certain product lines, a number of other companies including Thomson Video Networks, Envivio, RGB Networks, Sumavision Technologies and Elemental Technologies. In production and

playout products, competitors are Harris, Grass Valley, Miranda Technologies (a Belden Inc. company), EVS and Evertz Microsystems. In the cable edge product category, competitors include Arris, Cisco Systems, Casa Systems and CommScope. Consolidation in the industry has led to the acquisition of a number of our historic competitors over the last several years. For example, Motorola Home, BigBand Networks and C-Cor were acquired by Arris; NDS and Scientific Atlanta were acquired by Cisco Systems; Tandberg Television was acquired by Ericsson; and Miranda Technologies and Grass Valley were acquired by Belden Inc.

Many of our competitors are substantially larger, or as a result of consolidation activity have become larger, and have greater financial, technical, marketing and other resources than we have, and have been in operation longer than us. In addition, some of our larger competitors have more long-standing and established relationships with domestic and foreign customers. Many of these large enterprises are in a better position to withstand any significant reduction in capital spending by customers in our 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

Table of Contents

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 on more attractive financing or payment terms, which has in the past caused, 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.

If any of our competitors' products or technologies were to become the industry standard, our business could 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.

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;
- fail to meet market acceptance or customer requirements; or
- are ahead of the needs of their markets.

We are currently developing and marketing products based on established video compression standards, such as MPEG-4 AVC/H.264, which provides significantly greater compression efficiency, thereby making more bandwidth available to operators. We are also actively involved in developing products utilizing the latest encoding technologies, such as HEVC. At the same time, we continue to devote development resources to enhance the existing MPEG-2 compression of our products, which 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 our competitors will not take significant market share in encoding or transcoding.

In order to attempt to meet fast paced, dynamic, evolving standards and customer requirements, we are intensifying our development efforts on a number of our product solutions, including products that facilitate, enable and enhance multiscreen video, enhanced video compression and video quality technologies, media playout servers utilizing integrated channel playout, and CCAP-based cable edge products. We recently announced a software-based, fully virtualized platform that we are developing to unify the entire media processing chain, from ingest to delivery, and which is designed to operate on common server hardware in IT data center environments. We also recently introduced our first video processing and encoding software product based on this platform.

Many of these products and initiatives are intended to integrate existing and new features and functions in response to shifts in customer demands in the relevant market, as well as to general technology trends (such as virtualized and cloud-based computing) that we believe will significantly impact our industry. The success of these significant and costly development efforts will be predicated, for certain products and initiatives, on the timing of market adoption of the new standards on which the resulting products are based, and for other products, the timing of customer adoption of our fully virtualized software platform. If any of the new standards or our virtualized software platform are not adopted, are adopted later than we predict or adoption occurs earlier than we are able to deliver the applicable products, we risk spending significant research and development time and dollars on products that may never achieve market acceptance or that miss the customer demand window and thus do not produce the revenue that a timely introduction would have likely produced.

If we fail to develop and market new and enhanced products on a timely basis, our operating results, financial condition and cash flows could be materially and adversely affected.

## Table of Contents

Our CCAP product initiative exposes us to certain technology transition risks that may adversely impact our operating results, financial condition and cash flows.

In the last few years, the cable industry has begun to develop and promulgate the CCAP architecture for next-generation cable edge solutions, which combines edge QAM and CMTS functions in a single system in order to combine resources for video and data delivery. We believe CCAP-based systems will significantly reduce cable headend costs and increase operational efficiency, and are an important step in cable operators' transition to all-IP networks. We have begun to market and sell CCAP-based systems, and are developing full, two-way CMTS capabilities in our solution to make it fully-compliant with current CCAP architecture standards. If we are unsuccessful in developing these CMTS capabilities in a timely manner, or are otherwise delayed in making such capabilities available to our customers, our business may be adversely impacted, particularly if our competitors develop and market fully compliant products before we do.

We believe CCAP-based systems may, over time, replace and make obsolete current cable edge QAM solutions, including our cable edge QAM products, as well as current CMTS solutions, which is a market our products have previously not addressed. If demand for our CCAP-based systems is weaker than expected, or sales of our CCAP-based systems do not adequately offset the expected decline in demand for our non-CCAP cable edge products, or the decline in demand for our non-CCAP cable edge products is more rapid and precipitous than expected, our near and long-term operating results, financial condition and cash flows could be adversely impacted. Moreover, if a new or competitive architecture for next-generation cable edge solutions is promulgated that renders our CCAP-based systems obsolete, our business may be adversely impacted.

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, IP video services (particularly streaming to tablet computers, connected TVs and mobile devices), and very high-speed data services. The market demand for such emerging services is rapidly growing, with many custom 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, standards and devices, such as:

- the adoption of advanced video compression standards, such as next generation H.264 compression and HEVC;
- the CCAP architecture;
- fiber to the premises, or FTTP, 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 DOCSIS 3.0; and
- the introduction of new consumer devices, such as advanced set-top boxes, DVRs and NDVRs, connected TVs, tablet computers, and a variety of smart phone mobile devices.

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 operating results, financial

condition and cash flows could be materially and adversely affected.

Furthermore, other technological, industry and regulatory trends and requirements may affect the growth of our business.

These trends and requirements include the following:

- convergence, or the need of 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 and video-on-demand on the Internet;
- adoption of high bandwidth technology, such as DOCSIS 3.x, next generation LTE and FTTP;



Table of Contents

- the use of digital video by businesses, governments and educational institutions;
- efforts by regulators and governments in the U.S. and internationally to encourage the adoption of broadband and digital technologies;
- consumer interest in higher resolution video such as Ultra HDTV or retina-display technologies on mobile devices;
- the need to develop partnerships with other companies involved in video infrastructure workflow and broadband services;
- the continued adoption of the television viewing behaviors of consumers in developed economies by the growing middle class across emerging economies;
- 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
- 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 operating results, financial condition and cash flows could be materially and adversely affected.

We depend significantly on our international revenue and are subject to the risks associated with international operations, including those of our resellers, contract manufacturers and outsourcing partners, which may negatively affect our operating results.

Revenue derived from customers outside of the U.S. in the first three months of 2014 and 2013 represented approximately 50% and 58% of our revenue, respectively. Although no assurance can be given with respect to international sales growth in any one or more regions, we expect that international revenue will likely continue to represent, from year to year, a majority, and potentially increasing, percentage of our annual revenue for the foreseeable future. A significant percentage of our revenue is generated from sales to resellers, value-added resellers (VARs) and systems integrators, particularly in emerging market countries. Furthermore, a significant percentage of our employees are based in our international offices and locations, and most of our contract manufacturing occurs outside of the U.S. In addition, we outsource a portion of our research and development activities to certain third party partners with development centers located in different countries, particularly Ukraine and India.

Our international operations, the international operations of our resellers, contract manufacturers and outsourcing partners, 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 following:

- growth and stability of the economy in one or more international regions;
- fluctuations in currency exchange rates;
- changes in foreign government regulations and telecommunications standards;

- import and export license requirements, tariffs, taxes and other trade barriers;
- our significant reliance on resellers and others to purchase and resell our products and solutions, particularly in emerging market countries;
- availability of credit, particularly in emerging market countries;
- difficulty in collecting accounts receivable, especially from smaller customers and resellers, particularly in emerging market countries;

Table of Contents

- compliance with the U.S. Foreign Corrupt Practices Act, or FCPA, the U.K. Bribery Act, particularly in emerging market countries and/or similar anti-corruption and anti-bribery laws;
- 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;
- business and operational disruptions or delays caused by political, social and economic instability and unrest, including risks related to terrorist activity, particularly in emerging market countries (e.g., recent significant civil, political and economic disturbances in Russia, Ukraine and the Crimean peninsula); and
- changes in economic policies by foreign governments, including the imposition and potential expansion of economic sanctions by the U.S. and the European Union on the Russian Federation.

While most of our international revenue is 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. Also, if the U.S. dollar were to weaken against many foreign currencies, there can be no assurance that a weaker dollar would lead to growth in capital spending.

We have certain international customers who are billed in their local currency, primarily the Euro, British pound and Japanese yen, which subjects us to foreign currency risk. In addition, a portion of our operating expenses relating to the cost of certain international employees, are denominated in foreign currencies, primarily the Israeli shekel, British pound, Euro, Singapore dollar, Chinese yuan and Indian rupee. 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 our 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 U.S. also require us to comply with a number of U.S. and international regulations that prohibit improper payments or offers of payments to foreign governments and their officials and political parties for corrupt purposes. For example, our operations in countries outside the U.S. are subject to the FCPA and similar laws, including the U.K. Bribery Act. Our activities in certain emerging countries create the risk of unauthorized payments or offers of payments by one of our employees, consultants, sales agents or channel partners that could be in violation of various anti-corruption laws, even though these parties may not be under our control. Under the FCPA and U.K. Bribery Act, companies may be held liable for the corrupt actions taken by their directors, officers, employees, channel partners, sales agents, consultants, or other strategic or local partners or representatives. We have internal control policies and procedures with respect to FCPA compliance, have implemented FCPA training and compliance programs for our employees, and include in our agreements with resellers a requirement that those parties comply with the FCPA. However, we cannot provide assurances that our policies, procedures and programs will prevent violations of the 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 and adverse effect on our business, financial condition, operating results and cash flows.

We purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources, and we rely 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 one supplier for certain video encoding chips which are incorporated into several products. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our reliance on contractors for manufacturing and installation of our products, involves several risks, including a potential inability to obtain an adequate supply of required components, subassemblies or modules, reduced control over costs, quality and timely delivery of components, subassemblies or modules, and timely installation of products.

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. Further, these risks could

Table of Contents

materially and adversely affect our business if one of our sole sources, or a sole source of one of our suppliers or contract manufacturers, is adversely affected by a natural disaster. While we expend resources to qualify additional component sources, consolidation of suppliers 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.

Plexus Services Corp., which manufactures our products at its facilities in Malaysia, currently serves as our primary contract manufacturer, and currently provides us with a substantial majority, by dollar amount, of the products that we purchase from our contract manufacturers. Most of the products manufactured by our Israeli operations are outsourced to another third party manufacturer in Israel. 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. Our agreement with Plexus has automatic annual renewals, unless prior notice is given by either party, and has been automatically renewed until October 2014.

Difficulties in managing relationships with any of our current contract manufacturers, particularly Plexus, that manufacture our products off-shore, or any of our suppliers of key components, subassemblies and modules used in our products, could impede our ability to meet our customers' requirements and adversely affect our operating results. An inability to obtain adequate and timely deliveries of our products or any materials used in our products, or the inability of any of our contract manufacturers to scale their production to meet demand, 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 revenue and other operating results. Furthermore, if we fail to meet customers' supply expectations, our revenue would be adversely affected and we may lose sales opportunities, both short and long term, which could materially and adversely affect our business and our operating results, financial condition and cash flows. Increases, from time to time, in demand on our suppliers and subcontractors from our customers or from other parties have, on occasion, caused delays in the availability of certain components and products. In response, we may increase our inventories of certain components and products and expedite shipments of our products when necessary. These actions could increase our costs and could also increase our risk of holding obsolete or excess inventory, which, despite our use of a demand order fulfillment model, could materially and adversely affect our business, operating results, financial position and cash flows.

The loss of one or more of our key customers, a failure to continue diversifying our customer base, or a decrease in the number of larger transactions could harm our business and our operating results.

Historically, a significant portion 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. Sales to our top ten customers in the first three months ended 2014 and 2013 accounted for approximately 47% and 35% of revenue, respectively. Although we have broadened our customer base by further penetrating new markets and expanding internationally, we expect to see continuing industry consolidation and customer concentration.

In the first three months ended 2014 and 2013, revenue from Comcast accounted for approximately 20% and 9% of our revenue, respectively, and further consolidation in the cable industry, such as Comcast's recently announced intention to acquire Time Warner Cable, could lead to additional revenue concentration for us. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any other significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect, either long term or in a particular quarter, our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions. A decrease in the number of the relatively larger individual transactions in which we are involved in any quarter could materially and adversely affect our operating

results for that quarter.

As a result of these and other factors, we may be unable to increase our revenues from some or all of the markets we address, 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.

We rely on resellers, 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 or the processes and procedures that support them could adversely affect our business.

We generate a significant percentage of our revenue through sales to resellers, value-added resellers (VARs) and systems integrators that 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 channel partners.

38

---

Table of Contents

We generally have no long-term contracts or minimum purchase commitments with any of our reseller, 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 any of our reseller, VAR or systems integrator customers to favor their products or, in effect, to prevent or reduce sales of our products. Any of our reseller, VAR or systems integrator customers may independently choose not to purchase or offer our products. Many of our resellers, and some of our 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 affect our business, operating results, financial condition and cash flows. In addition, our failure to continue to establish or maintain successful relationships with reseller, VAR and systems integrator customers could likewise materially and adversely affect our business, operating results, financial condition and cash flows.

We may not be able to effectively manage our operations or implement strategic organizational initiatives.

In recent years, we have grown significantly, principally through acquisitions, and expanded our international operations. Upon the closing of our acquisition of Scopus in 2009, we added 221 employees, most of whom are based in Israel. Upon the closing of the acquisition of Omneon in 2010, we added 286 employees, most of whom are based in the U.S.

As of March 28, 2014, we had 489 employees in our international operations, representing approximately 47% of our worldwide workforce. Our ability to manage our business effectively in the future, including with respect to any future growth, the integration of any acquisition efforts, 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 assurance that we will be successful in any of these efforts, and our failure to effectively manage our operations could have a material and adverse effect on our business, operating results, cash flows and financial condition.

The fact that our employees are spread out in offices around the world also may present additional challenges when we initiate certain strategic initiatives. For example, we have recently launched a comprehensive program to increase the efficiency and effectiveness of our worldwide sales organization. There can be no assurance that this initiative will achieve success or improve our revenue, operating results or financial condition. We may encounter communication, coordination, management and motivational challenges as we work to align our global sales teams with the stated objectives of this program, which could cause disruptions and delays within the sales organization and in their sales activities. In addition, the investment and costs associated with this strategic initiative may be greater than anticipated, and may outweigh any benefits achieved, which could adversely affect our operating results.

We face risks associated with having outsourced engineering resources located in Ukraine.

We outsource a portion of our research and development activities to a third party partner with engineering resources located in Ukraine. Political, social and economic instability and unrest or violence in Ukraine, including any conflict with Russia, could cause disruptions to the business and operations of our outsourcing partner, which could slow or delay the development work our partner is undertaking or us. Instability, unrest or conflict could limit or prevent our employees from traveling to or from, or within, Ukraine to direct and coordinate our outsourced engineering teams, or cause us to shift all or portions of the development work occurring in Ukraine to other locations. The resulting delays could negatively impact our product development efforts and our business.

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 in the U.S., Europe and in other foreign markets;
- economic and financial conditions specific to each of the cable, satellite and telco, and broadcast and media industries, as well as general economic and financial market conditions;



Table of Contents

- changes in market acceptance of and demand for our products or our customers' services or products
- the timing and amount of orders, especially from large individual transactions and transactions with our significant customers;
- the mix of our products sold and the effect it has on gross margins;
- the timing of revenue recognition, including revenue recognition on sales arrangements and from transactions with significant service and support components, which may span several quarters;
- the timing of completion of our customers' projects;
- the length of each customer product upgrade cycle and the volume of purchases during the cycle;
- competitive market conditions, including pricing actions by our competitors;
- the level and mix of our domestic and international revenue;
- new product introductions by our competitors or by us;
- changes in domestic and international regulatory environments affecting our business;
- the evaluation of new services, new standards and system architectures by our customers;
- the cost and timely availability to us of components, subassemblies and modules;
- the mix of our customer base, by industry and size, and sales channels;
- changes in our operating and extraordinary expenses;
- the timing of acquisitions and dispositions by us and the financial impact of such transactions;
- impairment of our goodwill and intangibles;
- the impact of litigation, such as related litigation expenses and settlement costs;
- write-downs of inventory and investments;
- whether the research and development tax is renewed for 2014 and beyond;
- changes in our effective federal tax rate, including as a result of changes in our valuation allowance against our deferred tax assets, and changes in our effective state tax rates, including as a result of apportionment;
- 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; and

- 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.

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 third party equipment and services, 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 revenue 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

Table of Contents

expenses are relatively fixed in the short term. Accordingly, even small variations in the 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.

Fluctuations in our future effective tax rates, or the outcome of tax audits, 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. We continue to maintain a valuation allowance for certain foreign and California deferred tax assets. The realization of our deferred tax assets is dependent upon the generation of sufficient U.S. and foreign taxable income in the future to offset these assets. We may not have sufficient taxable income in the future to determine that we will be able to realize some significant portion of our deferred tax assets. As a result, an additional valuation allowance against our deferred tax assets may be required in the period in which such a determination is made, and our operating results could be materially and adversely impacted in the period of adjustment.

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 operating results for the applicable period.

In addition, recent statements from the Internal Revenue Service have indicated their intent to seek greater disclosure by companies of their reserves for uncertain tax positions.

Our 2008, 2009 and 2010 U.S. corporate income tax returns were audited by the Internal Revenue Service ("IRS") and a subsidiary of the Company was under audit by the Israel tax authority for the years 2007 through 2011. However, the statute of limitations for the audit of our 2008 and 2009 tax years by the IRS expired during the third quarter of 2013, effectively ending the IRS audits for those years. As a result, we released \$39.0 million of tax reserves, including accrued interests and penalties, for those tax years. Further, the audits by the Israel tax authority for our 2007 through 2011 tax years ended in the third quarter of 2013, and we reached a settlement with the Israel tax authority that did not involve any material adjustments. If, upon the conclusion of the remaining IRS audit for 2010 and the expiration of the related statute of limitations, the ultimate determination of taxes owed in the U.S. is for an amount in excess of the tax provision we recorded in 2010, our overall tax expense, effective tax rate, operating results and cash flow could be materially and adversely impacted in the period of adjustment.

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, and 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 U.S. federal statutory tax rate and, as a consequence, our effective income tax rate is expected to be lower than the U.S. federal statutory rate.

Our future effective income tax rates could be adversely affected if tax authorities challenge our international tax structure or if the relative mix of U.S. and international income changes for any reason. Accordingly, there can be no assurance that our income tax rate will be less than the U.S. 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 telecommunications industry have extensive patent portfolios. Also, patent infringement claims and litigation by entities that purchase or control patents, but do not produce goods or services covered by the claims of such patents (so-called “non-practicing entities” or “NPEs”), have increased rapidly

Table of Contents

over the last decade or so. From time to time, third parties, including NPEs, have asserted, and may assert in the future, patent, copyright, trademark and other intellectual property rights against us or our customers. For example, in October 2011, Avid Technology, Inc. filed a complaint against us in the United States District Court for the District of Delaware alleging that our MediaGrid product infringes two patents held by Avid. In February 2014, a jury determined that we had not infringed on either of these patents. Although we were able to successfully defend ourselves against the allegations by Avid, we may in the future be subject to additional allegations of infringement. 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 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 and temporary or permanent injunctions and 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 and adverse effect on our business, operating results, financial condition and cash flows.

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. If a supplier or a customer seeks to enforce a claim for indemnification against us, we could incur significant costs defending such claim, the underlying claim or both. An adverse determination in either such proceeding could subject us to significant liabilities and have a material and adverse effect on our operating results, cash flows and financial condition.

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

We may be subject to claims arising in the normal course of business. The costs of defending any litigation, whether in 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 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 and adverse effect on our business, operating results, financial condition and cash flows.

We face risks associated with having facilities and employees located in Israel

We maintain facilities in two locations in Israel with a total of 186 employees, or approximately 18% of our worldwide workforce, as of March 28, 2014. Our employees in Israel engage in a number of activities, including research and development, the development of, and supply chain management for, certain product lines, 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 or from, 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 approximately 14% of those employees were called for active military duty in 2013. 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, operating results, financial condition and cash flows.

We have made, and may continue to make, acquisitions, and any acquisition could disrupt our operations, cause dilution to our stockholders and materially and adversely affect our business, operating results, cash flows and financial condition.

As part of our business strategy, from time to time we have acquired, and we may continue to acquire, businesses, technologies, assets and product lines that we believe complement or expand our existing business. Acquisitions involve numerous risks, including the following:

Table of Contents

- unanticipated costs or delays associated with an acquisition;
- difficulties in the assimilation and integration of acquired operations, technologies and/or products;
- potential disruption of our business and the diversion of management’s attention from the regular operations of the business during the acquisition process;
- the challenges of managing a larger and more geographically widespread operation and product portfolio after the closing of the acquisition;
- potential adverse effects on new and existing business relationships with suppliers, contract manufacturers, resellers, partners and customers;
- risks associated with entering markets in which we may have no or limited prior experience;
- the potential loss of key employees of acquired businesses and our own business as a result of integration;
- difficulties in bringing acquired products and businesses into compliance with applicable legal requirements in jurisdictions in which we operate and sell products;
- impact of known potential liabilities or unknown liabilities, including litigation and infringement claims, associated with companies we acquire;
- substantial charges for acquisition costs or 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;
- delays in realizing, or failure to realize, the anticipated benefits of an acquisition; and
- the possibility that any acquisition may be viewed negatively by our customers or investors or the financial markets.

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 assume substantial 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, cash flows and financial condition or the price of our common stock. Alternatively, due to difficulties in the capital or credit markets at the time, we may be unable to secure capital necessary to complete an acquisition on reasonable terms, or at all. 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.

As of March 28, 2014, we have approximately \$198 million of goodwill recorded on our balance sheet associated with prior acquisitions. In the event we determine that our goodwill is impaired, we would be required to write down all or a portion of such goodwill, which could result in a material non-cash charge to our results of operations in the period in which such write-down occurs.



Table of Contents

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

We may sell one or more of our product lines, from time to time, as a result of our evaluation of our products and markets, and any such divestiture could adversely affect our continuing business and our expenses, revenues, results of operation, cash flows and financial position.

We periodically evaluate our various product lines and may, as a result, consider the divestiture of one or more of those product lines. Any such divestiture could adversely affect our continuing business and expenses, revenues, results of operations, cash flows and financial position.

On February 18, 2013, we entered into an Asset Purchase Agreement with Aurora Networks pursuant to which we agreed to sell our cable access HFC business (the “Business”) for \$46 million in cash. This disposition of the Business closed on March 5, 2013. Revenue from this Business in 2012 was approximately \$53 million, which represented approximately 10% of our revenue for the year.

Divestitures of product lines have inherent risks, including the expense of selling the product line, the possibility that any anticipated sale will not occur, delays in closing any sale, the risk of lower-than-expected proceeds from the sale of the divested business, unexpected costs associated with the separation of the business to be sold from the seller’s information technology and other operating systems, and potential post-closing claims for indemnification or breach of transition services obligations of the seller. Expected cost savings, which are offset by revenue losses from divested businesses, may also be difficult to achieve or maximize due to the seller’s fixed cost structure, and a seller may experience varying success in reducing fixed costs or transferring liabilities previously associated with the divested business.

Our operating results could be adversely affected by natural disasters affecting the Company or impacting our third-party manufacturers, suppliers, resellers or customers.

Our corporate headquarters is located in California, which is prone to earthquakes. We have employees, consultants and contractors located in regions and countries around the world. In the event that any of our business, sales or research and development centers or offices in the U.S. or internationally are adversely affected by an earthquake or by any other natural disaster, we may sustain damage to our operations and properties, which could cause a sustained interruption or loss of affected operations, and cause us to suffer significant financial losses.

We rely on third-party contract manufacturers for the production of our products. Any significant disruption in the business or operations of such manufacturers or of their or our suppliers could adversely impact our business. Our principal contract manufacturers and several of their and our suppliers and our resellers have operations in locations that are subject to natural disasters, such as severe weather, tsunamis, floods and earthquakes, which could disrupt their operations and, in turn, our operations.

In addition, if there is a 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, or both, which may materially impair their ability to continue their purchase of products from us. Accordingly, natural disaster in one of the geographies in which we, or our third party manufacturers, their or our suppliers or our customers, operate could have a material and adverse effect on our business, operating results, cash flows and financial condition.

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. We cannot provide assurances that changes of management personnel in the future would not cause disruption to 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

Table of Contents

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 operating results.

We could be negatively affected as a result of a future proxy contest and the actions of activist stockholders.

If a proxy contest with respect to election of our directors is initiated in the future, or if other activist stockholder activities occur, our business could be adversely affected because:

- responding to a proxy contest and other actions by activist stockholders can be costly and time-consuming, disrupting our operations and diverting the attention of management and our employees;
- perceived uncertainties as to our future direction caused by activist activities may result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners; and
- if individuals are elected to our Board of Directors with a specific agenda, it may adversely affect our ability to effectively and timely implement our strategic plans.

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

At March 28, 2014, we held 53 issued U.S. patents and 33 issued foreign patents, and had 22 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 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 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 materially and adversely affect our business, operating results, financial condition and cash flows.

Recently reported hacking attacks on government and commercial computer systems, particularly attacks sponsored by foreign governments or enterprises, raise the risks that such an attack may compromise, in a material respect, one or more of our computer systems and permit hackers access to our proprietary information and data. If such an attack does, in fact, allow access to or theft of our proprietary information or data, our business, operating results, financial condition and cash flows could be materially and adversely affected.

Our products include third-party technology and intellectual property, and our inability to acquire new technologies or use third-party technology in the future could harm our business.

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 companies with technology useful to us are often willing to enter into technology development or licensing agreements with respect to such technology, we cannot provide assurances that such agreements may be negotiated on commercially reasonable terms, or at all. The failure to enter, or a delay in entering, into such 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.

We incorporate certain third-party technologies, including software programs, into our products, and, as noted, intend to utilize additional third-party technologies in the future. 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

Table of Contents

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, operating results, financial condition and cash flows.

Our use of open source software in some of our products may expose us to certain risks

Some of our products contain software modules licensed for use from third-party authors under open source licenses. Use and distribution of open source software may entail greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the type of open source software we use. If we combine our proprietary software with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software to the public. This could allow our competitors to create similar products with lower development effort and in less time and ultimately could result in a loss of product sales for us.

Although we monitor our use of open source closely, it is possible our past, present or future use of open source has triggered or may trigger the foregoing requirements. Furthermore, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely basis, any of which could materially and adversely affect our operating results, financial condition and cash flows.

We cannot assure you that our stock repurchase program will result in repurchases of our common stock or enhance long term stockholder value, and repurchases, if any, could affect our stock price and increase its volatility and will diminish our cash reserves.

In April 2013, our Board of Directors approved a modified “Dutch Auction” tender offer to repurchase up to \$100 million of shares of our common stock. The tender offer expired on May 24, 2013, and resulted in our repurchasing approximately 12 million shares of our common stock, at \$6.25 per share, for an aggregate purchase price of approximately \$75 million.

Following the tender offer, we resumed purchases under our stock repurchase program. Under the program, we are authorized to repurchase up to \$220 million of our common stock in open market transactions or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Exchange Act. As of March 28, 2014, we had purchased an aggregate of \$167 million of our common stock under this program, including under the tender offer. The timing and actual number of shares repurchased, if any, will depend on a variety of factors, including the price and availability of our shares, trading volume, general market conditions and projected cash positions. The program was suspended prior to the announcement of the tender offer, and may be suspended or discontinued at any time in the future without prior notice.

Repurchases pursuant to our tender offer and our stock repurchase program could affect our stock price and increase its volatility and will reduce the market liquidity for our stock. Additionally, these repurchases will diminish our cash reserves, which could impact our ability to pursue possible future strategic opportunities and acquisitions and would result in lower overall returns on our cash balances. There can be no assurance that any stock repurchases will, in fact, occur, or, if they occur, that they will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased shares of stock. Although our tender offer and our stock repurchase program are intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the effectiveness of these repurchases.

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 U.S. 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 delay 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 international customers.

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.

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.

We believe that our existing cash and short-term investments of approximately \$148 million at March 28, 2014, even as it may be reduced through possible future repurchases of our common stock under the stock repurchase program discussed above, will satisfy our cash requirements for at least the next twelve months. However, we may need to raise additional funds to take advantage of presently unanticipated strategic opportunities, satisfy our other cash requirements from time to time, or 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 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.

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 and the interest on such debt may adversely affect our operating results.

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.

Our business and industry are subject to various laws and regulations that could adversely affect our business, operating results, cash flows and financial condition.

Our business and industry are regulated under various federal, state, local and international laws. For example, we are subject to environmental regulations such as the European Union's Waste Electrical and Electronic Equipment (WEEE) and Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directives and similar legislation enacted in other jurisdictions worldwide. 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 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 would 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 and adverse effect on our operating results, financial condition and cash flows.

We are subject to the Sarbanes-Oxley Act of 2002 which, among other things, requires an annual review and evaluation of our internal control over financial reporting. 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 may incur substantial additional costs in an effort to correct such problems, and investors may lose confidence in our financial statements, and our stock price may decrease in the short term, until we correct such problems, and perhaps in the long term, as well.

We are subject to new requirements under the Dodd-Frank Act of 2010 that will require us to conduct research, disclose, and report whether or not our products contain certain conflict minerals sourced from the Democratic Republic of Congo or its surrounding countries. The implementation of these new requirements could adversely affect the sourcing, availability, and pricing of the materials used in the manufacture of components used in our products. In addition, we will incur additional costs



## Table of Contents

to comply with the disclosure requirements, including costs related to conducting diligence procedures to determine the sources of conflict minerals that may be used or necessary to the production of our products and, if applicable, potential changes to products, processes or sources of supply as a consequence of such verification activities. It is also possible that we may face reputational harm if we determine that certain of our products contain minerals not determined to be conflict-free and/or we are unable to alter our products, processes or sources of supply to avoid such materials.

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.

Some anti-takeover provisions contained in our certificate of incorporation and bylaws, 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 of Directors 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 could delay hostile takeovers, changes in control of the Company or changes in our management. 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 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;
- increases or decreases in the general stock market or to the stock prices of technology companies;
- 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, dispositions, strategic partnerships, joint ventures or capital commitments;

Table of Contents

- announcements by our customers regarding end user market conditions and the status of existing and future infrastructure network deployments;
- the repurchase of over 20% of our outstanding shares since 2012 pursuant to our ongoing stock repurchase program and the tender offer we completed in 2013, as well as any future repurchases under our stock repurchase program;
- 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 issue additional shares upon exercise of stock options, including under our Employee Stock Purchase Plan, and in connection with grants of restricted stock units on an ongoing basis. 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.

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

On April 24, 2012, the Board of Directors approved a stock repurchase program that provided for the repurchase of up to \$25 million of the Company's outstanding common stock during the term of the program. On January 28, 2013, our Board of Directors approved a \$75 million increase to the existing \$25 million stock repurchase program. On February 19, 2013, the Board approved a further \$35 million increase to the program upon the closing of a sale of the Company's cable access HFC business. On July 16, 2013, the Board approved a further \$85 million increase to the program, resulting in an aggregate of \$220 million in purchases approved under the program.

Under the program, we are authorized to repurchase shares of common stock in open market transactions or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Exchange Act. The timing and actual number of shares repurchased, if any, will depend on a variety of factors, including the price and availability of our shares, trading volume and general market conditions. The program may be suspended or discontinued at any time without prior notice.

As of March 28, 2014, we had purchased 27.7 million shares of common stock under this program at a weighted average price of \$6.03 per share for an aggregate purchase price of \$167.3 million, excluding fees. The remaining authorized amount for stock repurchases under this program was \$52.7 million as of March 28, 2014.



Table of Contents

The table below sets forth the stock repurchase activity for the quarter ended March 28, 2014 (in thousands, except per share amounts):

Period	Total Number of Shares Repurchased	Average Price Paid per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan or Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan or Program
January 1, 2014 - January 24, 2014	613	\$7.21	613	\$ 77,364
January 25, 2014 - February 21, 2014	1,645	\$6.53	1,645	\$ 66,630
February 22, 2014 - March 28, 2014	2,102	\$6.62	2,102	\$ 52,707
	4,360	\$6.67	4,360	

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit  
Number      Exhibit Index

31.1<sup>(1)</sup>      Section 302 Certification of Principal Executive Officer

31.2<sup>(1)</sup>      Section 302 Certification of Principal Financial Officer

32.1<sup>(2)</sup>      Section 906 Certification of Principal Executive Officer

32.2<sup>(2)</sup>      Section 906 Certification of Principal Financial Officer

101          The following materials from Registrant's Quarterly Report on Form 10-Q for the quarter ended March 28, 2014, formatted in Extensible Business Reporting Language (XBRL) includes:

(i) Condensed Consolidated Balance Sheets at March 28, 2014 and December 31, 2013, (ii) Condensed Consolidated Statements of Operations for the three months ended March 28, 2014 and March 29, 2013, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 28, 2014 and March 29, 2013, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended March 28, 2014 and March 29, 2013, and (v) Notes to Condensed Consolidated Financial Statements.

(1) Filed herewith

(2) Furnished herewith

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 5, 2014